

12 July 2006

**BASE PROSPECTUS**

# Morgan Stanley

*as issuer and guarantor  
(incorporated under  
the laws of the State of Delaware in the United States of America)*

**MORGAN STANLEY (JERSEY) LIMITED**  
*as issuer  
(incorporated with limited liability in Jersey, Channel Islands)*

**MORGAN STANLEY B.V.**  
*as issuer  
(incorporated with limited liability in The Netherlands)*

## **Program for the Issuance of Notes, Series A and B**

Under the program (the "**Program**") described in this base prospectus (the "**Base Prospectus**"), Morgan Stanley ("**Morgan Stanley**"), Morgan Stanley (Jersey) Limited ("**Morgan Stanley Jersey**") and Morgan Stanley B.V. ("**MSBV**") or any of Morgan Stanley's subsidiaries that accedes to the Program (each, an "**Additional Issuer**" and, together with Morgan Stanley, Morgan Stanley Jersey and MSBV, the "**Issuers**" and each, an "**Issuer**") may offer from time to time Series A Notes and Series B Notes (together, the "**Notes**"). Each Additional Issuer shall prepare a base prospectus.

References herein to "this Base Prospectus" shall, where applicable, be deemed to be references to this Base Prospectus as supplemented or amended from time to time. To the extent not set forth in this Base Prospectus, the specific terms of any Note will be included in the appropriate Final Terms.

The payment of all amounts due in respect of Notes issued by Morgan Stanley Jersey, MSBV or an Additional Issuer will, unless specified otherwise in the appropriate Final Terms or, in the case of an Additional Issuer, in the accession agreement pursuant to which such Additional Issuer accedes to the Program, be unconditionally and irrevocably guaranteed by Morgan Stanley (in such capacity, the "**Guarantor**") pursuant to a deed of guarantee dated as of 10 June 2002.

Each Issuer is offering the Notes on a continuing basis through Morgan Stanley & Co. International Limited and Morgan Stanley & Co. Incorporated (the "**Distribution Agents**"), who have agreed to use reasonable efforts to solicit offers to purchase the Notes. Each Issuer may also sell Notes to the Distribution Agents as principal for their own accounts at a price to be agreed upon at the time of sale. The Distribution Agents may resell any Notes they purchase as principal at prevailing market prices, or at other prices, as they determine. Each Issuer or the Distribution Agents may reject any offer to purchase Notes, in whole or in part. See "Subscription and Sale" beginning on page 194.

This Base Prospectus (which shall constitute the Morgan Stanley Base Prospectus, the Morgan Stanley Jersey Base Prospectus and the MSBV Base Prospectus (each as defined below)) has been approved by the Financial Services Authority (the "**FSA**") in its capacity as United Kingdom competent authority for the purposes of Directive 2003/71/EC (the "**Prospectus Directive**") and relevant implementing measures in the United Kingdom as a base prospectus issued in compliance with the Prospectus Directive and relevant implementing measures in the United Kingdom for the purpose of giving information with regard to the issue of Notes under the Program issued within 12 months following the date of this document. Applications have been made for the Series A Notes to be admitted to listing on the Official List of the

FSA and to trading on the London Stock Exchange's regulated market for gilt edged and fixed income securities during the period from and including the date hereof up to but excluding 12 July 2007.

The proposed European Union Transparency Obligations Directive (the "**Directive**") may be implemented in a manner which could be burdensome for companies such as an Issuer or the Guarantor (if applicable). In particular, companies may be required to publish financial statements more frequently than they otherwise would or to prepare financial statements in accordance with accounting standards other than the ones they would otherwise utilise, for example the Guarantor may be required to prepare financial statements in accordance with accounting standards other than U.S. GAAP. None of the Issuers is under any obligation to maintain the listing of any Notes, and prospective purchasers should be aware that, in circumstances where an admission to listing of the Notes by the UK Listing Authority or any other listing authority would require publication by the relevant Issuer or the Guarantor (if applicable) of financial statements more frequently than either would otherwise prepare them or preparation by Morgan Stanley (as Issuer or Guarantor, as applicable) of financial statements in accordance with standards other than U.S. GAAP, or in any other circumstances where the Directive is implemented in a manner that, in the opinion of the Issuer or the Guarantor (if applicable), is burdensome for the relevant Issuer or Guarantor (if applicable), the Notes may be de-listed. In such a case of de-listing, the relevant Issuer may, but is not obliged to, seek an alternative listing for the Notes on a stock exchange outside the European Union. However, if such an alternative listing is not available or is, in the opinion of the relevant Issuer or the Guarantor (if applicable), burdensome, an alternative listing for the Notes may not be considered. Although no assurance is made as to the liquidity of the Notes as a result of listing by the UK Listing Authority, de-listing the Notes may have a material effect on a Noteholder's ability to resell the Notes in the secondary market.

The Morgan Stanley base prospectus (the "**Morgan Stanley Base Prospectus**") will comprise this base prospectus with the exception of (i) the information in the sections entitled (a) Morgan Stanley Jersey, (b) MSBV, (c) Jersey Taxation, (d) Netherlands Taxation, and (ii) Morgan Stanley Jersey's Annual Reports for the years ended 30 November 2004 and 30 November 2005, and MSBV's Annual Reports for the years ended 30 November 2004 and 30 November 2005, each of which is incorporated by reference herein.

The Morgan Stanley Jersey base prospectus (the "**Morgan Stanley Jersey Base Prospectus**") will comprise this base prospectus with the exception of the information in the sections entitled (a) MSBV (b) Key Features of the New York Law Notes (c) Description of New York Law Notes (d) Pro Forma Final Terms of the New York Law Notes, (e) Netherlands Taxation and (f) MSBV's Annual Reports for the years ended 30 November 2004 and 30 November 2005, which are incorporated by reference herein.

The MSBV base prospectus (the "**MSBV Base Prospectus**") will comprise this base prospectus with the exception of the information in the sections entitled (a) Morgan Stanley Jersey (b) Key Features of the New York Law Notes (c) Description of New York Law Notes (d) Pro Forma Final Terms of the New York Law Notes, (e) Jersey Taxation and (f) Morgan Stanley Jersey's Annual Reports for the years ended 30 November 2004 and 30 November 2005, which are incorporated by reference herein.

The aggregate principal amount of Notes outstanding issued under the Program shall not at any time exceed U.S.\$ 20,000,000,000. The Series B Notes will not be admitted to listing, trading and/or quotation by any listing authority, stock exchange and/or quotation system.

The Notes will be governed by, and construed in accordance with, either the laws of the State of New York ("**New York Law Notes**") or the laws of England and Wales ("**English Law Notes**"), as specified in the applicable Final Terms. Morgan Stanley Jersey, MSBV and each Additional Issuer may issue English Law Notes, but shall not issue New York Law Notes.

**Investing in the Notes involves risks. See "Risk Factors" beginning on page 12 of this Base Prospectus.**

**THE NOTES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR THE SECURITIES LAWS OF ANY STATE IN THE UNITED STATES, AND ARE SUBJECT TO U.S. TAX LAW REQUIREMENTS. THE NOTES MAY NOT BE OFFERED, SOLD OR DELIVERED AT ANY TIME, DIRECTLY OR INDIRECTLY, WITHIN THE UNITED STATES OR TO OR FOR THE ACCOUNT OR BENEFIT OF U.S. PERSONS (AS DEFINED IN EITHER REGULATION S UNDER THE SECURITIES ACT OR THE UNITED STATES INTERNAL REVENUE CODE OF 1986, AS AMENDED). SEE "SUBSCRIPTION AND SALE" AND "NO OWNERSHIP BY U.S. PERSONS."**

**Each investor must comply with all applicable laws and regulations in each country or jurisdiction in or from which the investor purchases, offers, sells or delivers the Notes or has in the investor's possession or distributes this Base Prospectus or any accompanying Final Terms.**

**MORGAN STANLEY**

Morgan Stanley accepts responsibility for information contained in the Morgan Stanley Base Prospectus, Morgan Stanley Jersey accepts responsibility for information contained in the Morgan Stanley Jersey Base Prospectus and MSBV accept responsibility for information contained in the MSBV Base Prospectus. To the best of the knowledge and belief of each of Morgan Stanley, Morgan Stanley Jersey and MSBV (each of which has taken all reasonable care to ensure that such is the case), the information contained in each of the Morgan Stanley Base Prospectus, the Morgan Stanley Jersey Base Prospectus and the MSBV Base Prospectus respectively is in accordance with the facts and does not omit anything likely to affect the import of such information.

No person has been authorised by any of Morgan Stanley, Morgan Stanley Jersey or MSBV to give any information or to make any representation not contained or incorporated by reference in this Base Prospectus, and, if given or made, that information or representation should not be relied upon as having been authorised by Morgan Stanley, Morgan Stanley Jersey or MSBV. Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any securities will, in any circumstances, create any implication that the information contained in this Base Prospectus is true subsequent to the date hereof or the date upon which this Base Prospectus has been most recently amended or supplemented or that there has been no adverse change in the financial situation of any of Morgan Stanley, Morgan Stanley Jersey or MSBV since the date hereof or, as the case may be, the date upon which this Base Prospectus has been most recently amended or supplemented or the balance sheet date of the most recent financial statements which have been incorporated into this Base Prospectus by way of a supplement to this Base Prospectus, or that any other information supplied from time to time is correct at any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same. Investors should review, inter alia, the most recent financial statements of Morgan Stanley, Morgan Stanley Jersey and/or MSBV (as applicable) when evaluating any securities or an investment therein (such financial statements shall not form a part of this Base Prospectus unless they have been expressly incorporated herein by way of a supplement to this Base Prospectus).

The distribution of this Base Prospectus and the offering, sale and delivery of securities in certain jurisdictions may be restricted by law. Persons into whose possession this Base Prospectus comes are required by Morgan Stanley, Morgan Stanley Jersey and MSBV to inform themselves about and to observe those restrictions.

This Base Prospectus should be read and construed with any amendment or supplement thereto and with any other documents incorporated by reference therein.

This Base Prospectus does not constitute an offer of or an invitation to subscribe for or purchase any securities and should not be considered as a recommendation by any of Morgan Stanley, Morgan Stanley Jersey or MSBV that any recipient of this Base Prospectus should subscribe for or purchase any securities. Each recipient of this Base Prospectus will be taken to have made its own investigation and appraisal of the condition (financial or otherwise) of Morgan Stanley, Morgan Stanley Jersey or MSBV (as applicable) and of the particular terms of any offered securities.

Neither this Base Prospectus nor any Final Terms may be used for the purpose of an offer or solicitation by anyone in any jurisdiction in which that offer or solicitation is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.

All references in this Base Prospectus to "Sterling" and "£" are to the lawful currency of the United Kingdom, all references to "U.S. dollars," "U.S.\$" and "\$" are to the lawful currency of the United States of America, all references to "Japanese Yen" and "¥" are to the lawful currency of Japan, all references to "Australian dollars" and "AUD" are to the lawful currency of the Commonwealth of Australia, all references to "New Zealand dollars" and "NZD" are to the lawful currency of New Zealand, and all references to "euro", "€" and "EUR" are to the single currency

introduced at the start of the third stage of the European Economic and Monetary Union pursuant to the Treaty establishing the European Community, as amended (the "Treaty").

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE RELEVANT ISSUER AND, WHERE APPLICABLE, THE GUARANTOR AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THESE NOTES HAVE NOT BEEN RECOMMENDED BY ANY UNITED STATES FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

IN CONNECTION WITH THE ISSUE OF ANY NOTES UNDER THE PROGRAM, ANY DISTRIBUTION AGENT OR ANY OTHER AGENT SPECIFIED FOR THAT PURPOSE IN THE APPLICABLE FINAL TERMS AS THE STABILIZING MANAGER (OR ANY PERSON ACTING FOR THE STABILIZING MANAGER) MAY OVER-ALLOT OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF ANY OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A LIMITED PERIOD. HOWEVER, THERE MAY BE NO OBLIGATION ON THE STABILIZING MANAGER (OR ANY AGENT OF THE STABILIZING MANAGER) TO DO THIS. SUCH STABILIZING, IF COMMENCED, MAY BE DISCOUNTED AT ANY TIME AND MUST BE BROUGHT TO AN END AFTER A LIMITED PERIOD. SUCH STABILIZING SHALL BE IN COMPLIANCE WITH ALL APPLICABLE LAWS, REGULATIONS AND RULES.

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## SUMMARY

*This summary has been prepared in accordance with Article 5(2) of the Prospectus Directive (Directive 2003/71/EC) (the "**Prospectus Directive**") and must be read as an introduction to the Base Prospectus relating to the Notes. This summary relates only to Notes with a denomination of less than EUR50,000. Any decision to invest in any Notes should be based on a consideration of the relevant Base Prospectus as a whole, including the documents incorporated by reference. Following implementation of the relevant provisions of the Prospectus Directive in a Member State of the European Economic Area, no civil liability will attach to the Issuer or the Guarantor (as applicable) solely on the basis of the summary, including any translation thereof, unless it is misleading, inaccurate or inconsistent when read together with the other parts of the relevant Base Prospectus. Where a claim relating to the information contained in the relevant Base Prospectus is brought before a court in a Member State of the European Economic Area, the plaintiff may, under the national legislation of the Member State where the claim is brought, be required to bear the costs of translating the relevant Base Prospectus before the legal proceedings are initiated.*

*Words and expressions defined in the "Terms and Conditions of the English Law Notes" below or elsewhere in this Base Prospectus have the same meanings in this summary.*

### **Essential characteristics and risks associated with Morgan Stanley, Morgan Stanley Jersey and MSBV**

#### *Morgan Stanley*

The auditors of Morgan Stanley for the periods 1 December 2002 to 30 November 2003, 1 December 2003 to 30 November 2004 and 1 December 2004 to 30 November 2005 were Deloitte & Touche LLP, an independent registered public accounting firm.

Morgan Stanley was originally incorporated for an unlimited term under the laws of the State of Delaware on 1 October 1981 under registered number 0923632, and its predecessor companies date back to 1924. On 31 May 1997, Morgan Stanley Group, Inc. was merged with and into Dean Witter Discover & Co. ("**Dean Witter Discover**") in a merger of equals. At that time, Dean Witter Discover changed its corporate name to Morgan Stanley, Dean Witter, Discover & Co. ("**MSDWD**"). On 24 March 1998 MSDWD changed its corporate name to Morgan Stanley Dean Witter & Co, and to Morgan Stanley on 20 June 2002. Morgan Stanley has its registered office at The Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801, U.S.A., and its principal executive offices at 1585 Broadway, New York, New York 10036, U.S.A., telephone number +1 (212) 761-4000.

As at the date of this Base Prospectus, Morgan Stanley's legal and commercial name is "Morgan Stanley".

Morgan Stanley is a holding company that provides its products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals, through its subsidiaries and affiliates. It is a global financial services firm that maintains significant market positions in each of its business segments - Institutional Securities, Global Wealth Management Group, Asset Management and Discover.

Morgan Stanley's objects and purposes are set out in its Certificate of Incorporation and enable it to engage in any lawful act or activity for which corporations may be organized and incorporated under the General Corporation Law of the State of Delaware.

The Directors of Morgan Stanley as of the date of this Base Prospectus are the following: John J. Mack, Roy J. Bostock, Erskine B. Bowles, Sir Howard J. Davies, C. Robert Kidder, Donald T. Nicolaisen, Charles H. Noski, Hutham S. Olayan, Charles E. Phillips, O. Griffith Sexton, Dr. Laura D. Tyson and Dr. Klaus Zumwinkel.

As at 31 May 2006, Morgan Stanley had 53,163 worldwide employees.

The authorised share capital of Morgan Stanley as at 31 May 2006 comprised 3,500,000,000 ordinary shares of nominal value U.S.\$0.01.

For the year ended 30 November 2005, total assets of Morgan Stanley amounted to U.S.\$898,523 million and total liabilities and shareholders' equity amounted to U.S.\$898,523 million. For the fiscal year ended 30 November 2004, total assets of Morgan Stanley amounted to U.S.\$747,334 million and total liabilities and shareholders' equity amounted to U.S.\$747,334 million.

There are a number of factors which could cause Morgan Stanley's actual results to differ, in some instances materially, from those anticipated. The factors set out below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties which face Morgan Stanley's business.

The results of Morgan Stanley's operations may be materially affected by market fluctuations and by economic and other factors such as 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.

Morgan Stanley faces strong competition from other financial services firms, which could lead to pricing pressures that could materially adversely affect its revenue and profitability.

The financial services industry faces substantial litigation and regulatory risks, and Morgan Stanley may face damage to its professional reputation and legal liability if its services are not regarded as satisfactory or for other reasons.

#### *Morgan Stanley Jersey*

Morgan Stanley Jersey was incorporated in St. Helier, Jersey, Channel Islands (registration number 35857) as a company with unlimited duration on 24 September 1986. It has its registered office at 22 Grenville Street, St. Helier, Jersey JE4 8PX, Channel Islands. Morgan Stanley Jersey's objects and purposes are not specified in any document and are therefore unlimited.

Morgan Stanley Jersey's business primarily consists of issuing financial instruments and the hedging of obligations relating thereto. All material assets of Morgan Stanley Jersey are obligations of (or securities issued by) one or more Morgan Stanley group companies. Morgan Stanley Jersey's auditors are Deloitte & Touche, Chartered Accountants and Registered Auditors.

Morgan Stanley Jersey has no subsidiaries and is wholly owned by Morgan Stanley.

The directors of Morgan Stanley Jersey are Joel Hodes, Charles Edward Crossley Hood and John Roberts. Morgan Stanley Jersey has no employees.

The authorised share capital of Morgan Stanley Jersey comprises 10,000 ordinary shares of nominal value GBP1. The issued, allotted and fully paid up share capital of Morgan Stanley Jersey comprises 10,000 ordinary shares of nominal value GBP1.

The (loss) / profit before tax for the financial years ended 30 November 2005 and 2004 was nil and U.S.\$(16,000) respectively. The current assets of Morgan Stanley Jersey have fallen from U.S.\$4,758,540,000 in 2004 to U.S.\$3,598,223,000 in 2005 with total creditors falling from U.S.\$4,758,084,000 in 2004 to U.S.\$3,597,767,000 in 2005.



All material assets of Morgan Stanley Jersey are obligations of (or securities issued by) one or more Morgan Stanley group companies. The obligations of Morgan Stanley Jersey pursuant to such hedging transactions are guaranteed by Morgan Stanley. If any of these Morgan Stanley group companies incur losses with respect to any of their activities (irrespective of whether those activities relate to Morgan Stanley Jersey or not) their ability to fulfil their obligations to Morgan Stanley Jersey could be impaired, thereby exposing holders of securities issued by Morgan Stanley Jersey to a risk of loss.

#### *MSBV*

MSBV was incorporated as a private company with limited liability under the laws of The Netherlands on 6 September 2001 for an unlimited duration. MSBV is registered at the commercial register of the Chamber of Commerce and Industries for Amsterdam under number 34161590. It has its corporate seat at Amsterdam and its offices are located at Locatellikade 1, 1076 AZ Amsterdam, The Netherlands. Telephone number +31 20 57 55 600.

MSBV's objects are, *inter alia*, to issue notes, warrants and other securities. All material assets of MSBV are obligations of (or securities issued by) one or more Morgan Stanley group companies. MSBV's auditors are Deloitte Accountants B.V. (members of the Royal Netherlands Institute of Registered Accountants).

MSBV has no subsidiaries and is ultimately controlled by Morgan Stanley.

The directors of MSBV are C.E.C Hood, J. Solan, G.C. De Boer and TMF Management B.V. MSBV has no employees.

The authorised share capital of MSBV comprises 900 ordinary shares of nominal value EUR100. The issued, allotted and fully paid up share capital of MSBV comprises 180 ordinary shares of nominal value EUR100.

MSBV's net revenue for the financial years ended 30 November 2005 and 2004 was EUR (1,614,000) and EUR 3,638,000, respectively, representing issuance fees received on the issuance of financial instruments less guarantee fees payable. The (loss)/profit before tax for the financial years ended 30 November 2005 and 2004 was EUR (1,475,000) and EUR3,660,000 respectively. During the period, no dividends were paid. The loss will be carried to reserves.

The current assets of MSBV rose from EUR 415,715,000 in 2004 to EUR 641,974,000 in 2005 with a total amount owing to creditors rising from EUR 126,158,000 to EUR 636,732,000 in 2005. The principal reason for the increase in debt was an increase in client demand for financial instruments.

All material assets of MSBV are obligations of (or securities issued by) one or more Morgan Stanley group companies. The obligations of MSBV pursuant to such transactions are substantially guaranteed by Morgan Stanley. If any of these Morgan Stanley group companies incur losses with respect to any of their activities (irrespective of whether those activities relate to MSBV or not) their ability to fulfil their obligations to MSBV could be impaired, thereby exposing holders of securities issued by MSBV to a risk of loss.

## **Essential characteristics and risks associated with the Notes**

Morgan Stanley, Morgan Stanley Jersey and MSBV may offer from time to time Series A Notes and Series B Notes. Applications have been made for the Series A Notes issued under the Program to be admitted to the Official List of the UK Listing Authority and to be admitted to trading on the London Stock Exchange's regulated market for gilt edged and fixed income securities during the period from the date of this document up to but excluding 12 July 2007. The Series B Notes will not be listed.

The payment of all amounts due in respect of Notes issued by Morgan Stanley Jersey or MSBV will, unless specified otherwise in the applicable Final Terms, be unconditionally and irrevocably guaranteed by Morgan Stanley.

Each Issuer is offering the Notes on a continuing basis through the Distribution Agents, who have agreed to use reasonable efforts to solicit offers to purchase the Notes. Each Issuer may also sell Notes to the Distribution Agents as principal for their own accounts at a price to be agreed upon at the time of sale. The Distribution Agents may resell any Notes they purchase as principal at prevailing market prices, or at other prices, as they determine. Each Issuer or the Distribution Agents may reject any offer to purchase Notes, in whole or in part.

Each Issuer will issue Notes in bearer form, which may be in either definitive form or global form. Notes in definitive bearer form will be serially numbered. Notes may be denominated or payable in any currency, be issued at any price and have any maturity, in each case subject to all applicable consents being obtained and compliance with all applicable legal and regulatory requirements.

Notes may be redeemed at par or at such other redemption amount (detailed in a formula or otherwise) or by delivery of securities of an issuer that is not affiliated with Morgan Stanley, as may be specified in the applicable Final Terms.

Early redemption will be permitted for taxation reasons but will otherwise be permitted only to the extent specified in the applicable Final Terms. Notes may be interest-bearing or non-interest-bearing. Interest (if any) may accrue at a fixed rate, which may be zero, or floating rate, or at a rate which varies during the lifetime of the relevant Series.

Notes issued by MSBV will be issued in denominations of at least EUR 1,000 per Note. Notes issued by Morgan Stanley or Morgan Stanley Jersey may have any denomination.

The Notes may be governed by, and construed in accordance with, either the laws of the State of New York or the laws of England and Wales, as specified in the applicable Final Terms. Morgan Stanley Jersey and MSBV may issue English Law Notes, but shall not issue New York Law Notes.

The net proceeds from the sale of Notes will be used by the relevant Issuer for general corporate purposes, in connection with hedging its obligations under the Notes, or both.

Certain documents relating to the Notes will be available, during usual business hours on any week day, for inspection at JPMorgan Chase Bank, N.A., Trinity Tower, 9 Thomas More Street, London E1W 1YT and at J.P. Morgan Bank (Ireland) plc, J.P. Morgan House, International Finance Service Centre, Dublin 1, Ireland Dublin and also at the principal executive offices of Morgan Stanley and the registered offices of Morgan Stanley Jersey and MSBV.

The Issuers may issue Notes with principal and/or interest determined by reference to the credit of one or more entities not affiliated with the Issuers, to currency prices, commodity prices or to single securities, baskets of securities or indices or other assets or instruments. Any such Notes may entail significant risks not associated with a similar investment in fixed or floating rate debt securities, including a return that

may be significantly less than the return available on an investment in fixed or floating rate debt securities. In some cases such Notes may also carry the risk of a total or partial loss of principal.

## RISK FACTORS

*Prospective investors should read the entire Base Prospectus (and where appropriate, any relevant final terms). Words and expressions defined elsewhere in this Base Prospectus have the same meanings in this section. Investing in securities involves certain risks. Prospective investors should consider, among other things, the following:*

### **Risk Relating to Morgan Stanley**

**The results of Morgan Stanley's operations may be materially affected by market fluctuations and by economic and other factors.**

The results of Morgan Stanley's operations may be materially affected by market fluctuations and by 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 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 have been legislative, legal and regulatory developments related to Morgan Stanley's businesses that potentially could increase costs, thereby affecting future results of operations. These factors also may have an impact on Morgan Stanley's ability to achieve its strategic objectives.

The results of Morgan Stanley's Institutional Securities business, particularly results relating to its involvement in primary and secondary markets for all types of financial products, are subject to substantial fluctuations due to a variety of factors that Morgan Stanley cannot control or predict with great certainty, including variations in the fair value of securities and other financial products and the volatility and liquidity of global markets. Fluctuations also occur due to the level of global market activity, which, among other things, affects the size, number, and timing of investment banking client assignments and transactions and the realization of returns from Morgan Stanley's 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 Morgan Stanley's Global Wealth Management Group. In addition, fluctuations in global market activity could impact the flow of investment capital into or from assets under management and supervision and the way customers allocate capital among money market, equity, fixed income or other investment alternatives, which could negatively impact Morgan Stanley's Investment Management business. Furthermore, changes in economic variables, such as the number and size of personal bankruptcy filings, the rate of unemployment, and the level of consumer confidence and consumer debt, may substantially affect consumer loan levels and credit quality, which, in turn, could impact the results of Morgan Stanley's Discover business.

**Liquidity is essential to Morgan Stanley's businesses and Morgan Stanley relies on external sources to finance a significant portion of its operations.**

**General.** Liquidity is essential to Morgan Stanley's businesses. Morgan Stanley's liquidity could be substantially negatively affected by an inability to raise funding in the long-term or short-term debt capital markets or an inability to access the secured lending markets. Factors that Morgan Stanley cannot control, such as disruption of the financial markets or negative views about the financial services industry generally, could impair its ability to raise funding. In addition, Morgan Stanley's ability to raise funding could be impaired if lenders develop a negative perception of its long-term or short-term financial prospects. Such negative perceptions could be developed if Morgan Stanley incurs large trading losses, it suffers a decline in the level of its business activity, regulatory authorities take significant action against it, or Morgan Stanley discovers serious employee misconduct or illegal activity, among other reasons. If Morgan Stanley is unable to raise funding using the methods described above, it would likely need to

liquidate unencumbered assets, such as its investment and trading portfolios, to meet maturing liabilities. Morgan Stanley may be unable to sell some of its assets, or it may have to sell assets at a discount from market value, either of which could adversely affect its results of operations.

**Credit Ratings.** The cost and availability of unsecured financing generally are dependent on Morgan Stanley's short-term and long-term credit ratings. Factors that are significant to the determination of Morgan Stanley's credit ratings or otherwise affect its ability to raise short-term and long-term financing include the level and volatility of its earnings; its relative competitive position in the markets in which Morgan Stanley operates; its geographic and product diversification; its ability to retain key personnel; its risk management policies; its cash liquidity; its capital adequacy; its 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 Morgan Stanley's credit ratings, thereby increasing its cost of obtaining unsecured funding.

Morgan Stanley's 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, Morgan Stanley would be required to provide additional collateral to certain counterparties in the event of a downgrade by either Moody's Investors Service or Standard & Poor's.

**Payments From Subsidiaries.** Morgan Stanley depends on dividends, distributions and other payments from its subsidiaries to fund dividend payments and to fund all payments on its obligations, including debt obligations. Regulatory and other legal restrictions may limit Morgan Stanley's ability to transfer funds freely, either to or from its subsidiaries. In particular, many of Morgan Stanley's subsidiaries, including its 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 Morgan Stanley's ability to access funds that it may need to make payments on its obligations.

**Liquidity and Funding Policies.** Morgan Stanley's liquidity and funding policies have been designed to ensure that it maintains sufficient liquid financial resources to continue to conduct its business for an extended period in a stressed liquidity environment. If Morgan Stanley's liquidity and funding policies are not adequate, it may be unable to access sufficient financing to service its financial obligations when they come due, which could have a material adverse franchise or business impact.

**Morgan Stanley is exposed to the risk that third parties that are indebted to it will not perform their obligations.**

Credit risk refers to the risk of loss arising from the default by a borrower, counterparty or other obligor when it is unable or unwilling to meet its obligations to Morgan Stanley. Morgan Stanley is exposed to three distinct types of credit risk in its businesses. Morgan Stanley incurs significant, "single-name" credit risk exposure through the Institutional Securities business. 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 Morgan Stanley and by extending credit to its clients through various credit arrangements. Morgan Stanley incurs "individual consumer" credit risk in the Global Wealth Management Group business through margin loans to individual investors and loans to small businesses, both of which are generally collateralized. Morgan Stanley incurs "consumer portfolio" credit risk in the Discover business primarily through cardholder receivables. Credit risk in a pool of cardholder receivables is generally highly diversified, without significant individual exposures, and, accordingly, is managed on a portfolio and not a single-name basis.

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

**Morgan Stanley faces strong competition from other financial services firms, which could lead to pricing pressures that could materially adversely affect its revenue and profitability.**

The financial services industry, and all of Morgan Stanley's businesses, are intensely competitive, and Morgan Stanley expects them to remain so. Morgan Stanley competes 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. Morgan Stanley competes on the basis of several factors, including transaction execution, capital or access to capital, its 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 Morgan Stanley's competitors gaining greater capital and other resources, such as a broader range of products and services and geographic diversity. Morgan Stanley may experience pricing pressures as a result of these factors and as some of its competitors seek to increase market share by reducing prices.

**Morgan Stanley's ability to retain and attract qualified employees is critical to the success of its business and the failure to do so may materially adversely affect its performance.**

Morgan Stanley's people are its most important resource and competition for qualified employees is intense. In order to attract and retain qualified employees, Morgan Stanley must compensate such employees at market levels. Typically, those levels have caused employee compensation to be Morgan Stanley's greatest expense as compensation is highly variable and moves with performance. If Morgan Stanley is unable to continue to attract and retain qualified employees, or if compensation costs required to attract and retain employees become more expensive, its performance, including its competitive position, could be materially adversely affected.

**Morgan Stanley is subject to extensive regulation in the jurisdictions in which it conducts its businesses.**

Morgan Stanley is subject to extensive regulation globally and faces the risk of significant intervention by regulatory authorities in the jurisdictions in which it conducts its businesses. Among other things, Morgan Stanley could be fined, prohibited from engaging in some of its business activities or subject to limitations or conditions on its business activities. Significant regulatory action against Morgan Stanley could have material adverse financial effects, cause significant reputational harm to it or harm its business prospects. New laws or regulations or changes in the enforcement of existing laws or regulations applicable to Morgan Stanley's clients may also adversely affect its business.

**The financial services industry faces substantial litigation and regulatory risks, and Morgan Stanley may face damage to its reputation and legal liability.**

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 its business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number of these investigations and proceedings has increased in recent years with regard to many firms in the financial services industry, including Morgan Stanley. Morgan Stanley is 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 Morgan Stanley could materially adversely affect its business, financial condition or results of operations or cause significant reputational harm to Morgan Stanley, which could seriously harm its business. For more information regarding legal proceedings in which Morgan Stanley and its subsidiaries are involved and in particular, the *Coleman Litigation*, see “Legal Proceedings” in Part I, Item 3 of Morgan Stanley’s Annual Report on Form 10-K for the fiscal year ended 30 November 2005 and Part II, Item 1 of Morgan Stanley’s Quarterly Reports on Form 10-Q for the quarterly periods ended 28 February 2006 and 31 May 2006, respectively.

**Conflicts of interest are increasing and a failure to appropriately deal with conflicts of interest could adversely affect Morgan Stanley's businesses.**

Morgan Stanley's reputation is one of its most important assets. As Morgan Stanley has expanded the scope of its businesses and its client base, it increasingly has to address potential conflicts of interest, including those relating to its proprietary activities. For example, conflicts may arise between Morgan Stanley's position as a financial advisor in a merger transaction and a principal investment it holds in one of the parties to the transaction. In addition, hedge funds and private equity funds are an increasingly important portion of Morgan Stanley's client base, and also compete with Morgan Stanley in a number of its businesses. Morgan Stanley has procedures and controls that are designed to address conflicts of interest. However, appropriately dealing with conflicts of interest is complex and difficult and Morgan Stanley's reputation could be damaged if it fails, or appears to fail, to deal appropriately with conflicts of interest. In addition, the United States Securities and Exchange Commission 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. It is possible that the regulatory scrutiny of, and litigation in connection with, conflicts of interest will make Morgan Stanley's clients less willing to enter into transactions in which such a conflict may occur, and will adversely affect its businesses.

**Morgan Stanley is subject to tax contingencies that could adversely affect reserves.**

Morgan Stanley is subject to the income tax laws of the U.S., its states and municipalities and those of the foreign jurisdictions in which Morgan Stanley has significant business operations. These tax laws are complex and subject to different interpretations by the taxpayer and the relevant governmental taxing authorities. Morgan Stanley must make judgments and interpretations about the application of these inherently complex tax laws when determining the provision for income 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.

**Morgan Stanley is subject to operational risk and an operational failure could materially adversely affect its businesses.**

Operational risk refers to the risk of loss arising from inadequate or failed internal processes, people and/or systems. Operational risk also refers to the risk that external events, such as external changes (e.g., natural disasters, terrorist attacks and/or health epidemics), failures or frauds, will result in losses to Morgan Stanley's businesses. Morgan Stanley incurs operational risk across all of its business activities, including revenue generating activities (e.g., such as sales and trading) and support functions (e.g., information technology and facilities management).

Morgan Stanley's businesses are highly dependent on its ability to process, on a daily basis, a large number of transactions across numerous and diverse markets in many currencies and the transactions Morgan Stanley processes have become increasingly complex. Morgan Stanley performs the functions required to operate its different businesses either by itself or through agreements with third parties. Morgan Stanley relies on the ability of its employees, its internal systems and systems at technology centers operated by third parties to process high numbers of transactions. Morgan Stanley also faces the risk of operational failure or termination of any of the clearing agents, exchanges, clearing houses or other financial intermediaries it uses to facilitate its securities transactions. In the event of a breakdown or improper operation of its or third-party's systems or improper action by third parties or employees, Morgan Stanley could suffer financial loss, an impairment to its liquidity, a disruption of its businesses, regulatory sanctions and damage to its reputation.

**Morgan Stanley's commodities activities subject it to extensive regulation, potential catastrophic events and environmental risks and regulation.**

In connection with the commodities activities in Morgan Stanley's Institutional Securities business, Morgan Stanley engages in the production, storage, transportation, marketing and trading of power, natural gas and petroleum. In addition, Morgan Stanley is the sole shareholder of wholesale electrical generators. As a result of these activities, Morgan Stanley is subject to extensive and evolving energy, environmental, safety and other governmental laws and regulations. Morgan Stanley's commodities business also exposes it to the risk of unforeseen and catastrophic events, including leaks, spills and terrorist attacks.

The power generation facilities in which Morgan Stanley is the sole shareholder are subject to wide-ranging U.S. federal, state and local environmental laws and regulations in the U.S. and abroad relating to air quality, water quality and hazardous and solid waste management. They also are regulated under U.S. health and safety regulations. These laws may require capital expenditures as well as remediation where the facility has failed to comply with environmental, health or safety rules or has released pollutants into the environment. Additionally, the owners of such facilities may be subject to fines or penalties for failure to comply with environmental, health or safety rules.

The U.S. water pollution laws and numerous specific oil spill anti-pollution statutes apply to Morgan Stanley's oil trading activities to the extent Morgan Stanley owns petroleum in storage or during waterborne or overland transit or it arranges for transportation or storage. In the event of an oil spill, one or more entities Morgan Stanley owns could be held responsible for remediation as well as property and natural resource damages. Other U.S. federal and state laws apply to the specifications of the gasoline and diesel fuel that Morgan Stanley blends and import and provide for substantial penalties in the event of non-compliance.

Oil pollution laws in non-U.S. jurisdictions also apply to Morgan Stanley in certain instances when it trades petroleum internationally and/or charter vessels. Like the U.S. statutes, these laws often provide for penalties and damage assessments should a spill event occur.

Although Morgan Stanley has attempted to mitigate its 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 from insurance recovery, if any, may not be adequate to cover liabilities with respect to particular incidents. As a result, Morgan Stanley's financial condition and results of operations may be adversely affected by these events.

Morgan Stanley also expects the other laws and regulations affecting its energy business to increase in both scope and complexity. During the past several years, intensified scrutiny of the 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 Morgan Stanley is engaged. Morgan Stanley may incur substantial costs in complying with current or future laws and regulations and its overall businesses and reputation may be adversely affected by the current legal environment.

**Morgan Stanley is subject to numerous political, economic, legal, operational and other risks as a result of its international operations that could adversely affect its business in many ways.**

Morgan Stanley is subject to political, economic, legal, operational 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. 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 Morgan Stanley to determine the exact requirements of local laws in every market. Morgan Stanley's inability to remain in compliance with local laws in a particular market could have a significant and negative effect not only on its businesses in that market but also on its reputation generally. Morgan Stanley is also subject to the enhanced risk that transactions it structures might not be legally enforceable in all cases.

In the last several years, various emerging market countries have experienced severe economic and financial disruptions, including significant devaluations of their currencies, capital and currency exchange controls, and low or negative growth rates in their economies. These conditions could adversely impact Morgan Stanley's 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 Morgan Stanley's ability to manage its businesses around the world.

**Morgan Stanley may be unable to fully integrate future acquisitions or joint ventures into its businesses and systems.**

Morgan Stanley expects to grow in part through acquisitions and joint ventures. To the extent Morgan Stanley makes acquisitions or enter into combinations or joint ventures, it faces 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, Morgan Stanley is subject to additional risks and uncertainties in that it may be dependent upon, and subject to liability, losses or reputational damage relating to, systems, controls and personnel that are not under its control. In addition, conflicts or disagreements between Morgan Stanley and its joint venture partners may negatively impact the benefits to be achieved by the joint venture.

**Morgan Stanley's Discover business subjects it to risks that impact the credit card industry.**

The performance of Morgan Stanley's Discover business is subject to numerous risks that impact the credit card industry, including rising cost of funds pressuring spreads; slow industry growth with rising payment rates; future loan loss rate uncertainty, especially given bankruptcy reform and changing

minimum payment requirements; and a consolidating industry with competitive pressures and increasing marketing constraints. Changes in economic variables, such as the number and size of personal bankruptcy filings, the rate of unemployment and the level of consumer confidence and consumer debt may substantially affect consumer loan levels and credit quality. Morgan Stanley's financial condition and results of operations may be adversely affected by these factors.

#### **Risks relating to Morgan Stanley Jersey**

All material assets of Morgan Stanley Jersey are obligations of (or securities issued by) one or more Morgan Stanley group companies. The obligations of Morgan Stanley Jersey pursuant to such transactions are guaranteed by Morgan Stanley. If any of these Morgan Stanley group companies incur losses with respect to any of their activities (irrespective of whether those activities relate to Morgan Stanley Jersey or not) their ability to fulfil their obligations to Morgan Stanley Jersey could be impaired, thereby exposing holders of securities issued by Morgan Stanley Jersey to a risk of loss.

#### **Risks relating to MSBV**

All material assets of MSBV are obligations of (or securities issued by) one or more Morgan Stanley group companies. The obligations of MSBV pursuant to such transactions are guaranteed by Morgan Stanley. If any of these Morgan Stanley group companies incur losses with respect to any of their activities (irrespective of whether those activities relate to MSBV or not) their ability to fulfil their obligations to MSBV could be impaired, thereby exposing holders of securities issued by MSBV to a risk of loss.

## Risks relating to the Notes

The Issuers disclaim any responsibility to advise prospective purchasers of any matters arising under the laws of the country in which they reside that may affect the purchase of, or holding of, or the receipt of payments on the Notes. These persons should consult their own legal and financial advisors concerning these matters. This section describes generally the most significant risks of investing in Notes linked to single securities, baskets of securities or indices, to commodity prices, to currency prices, to the credit of one or more entities not affiliated with the Issuers or to other assets. Each investor should carefully consider whether the Notes, as described herein and in the applicable Final Terms, are suited to its particular circumstances before deciding to purchase any Notes.

### *Notes linked to securities, indices, commodities, currencies and/or underlying credits*

The Issuers may issue Notes with principal and/or interest determined by reference to a single security or index, to baskets of securities or indices, to currency prices, commodity prices, to the credit of one or more entities not affiliated with the Issuers, or other assets or instruments (each, a "**Relevant Underlying**"). In addition, the Issuers may issue Notes with principal or interest payable in one or more currencies which may be different from the currency in which the Notes are denominated. Potential investors should be aware that:

- (a) they may lose all or a substantial portion of their principal;
- (b) the market price of such Notes may be very volatile;
- (c) they may receive no interest;
- (d) payment of principal or interest may occur at a different time or in a different currency than expected;
- (e) a Relevant Underlying may be subject to significant fluctuations that may not correlate with changes in interest rates, currencies or other indices;
- (f) if a Relevant Underlying is applied to Notes in conjunction with a multiplier greater than one or contains some other leverage factor, the effect of changes in the Relevant Underlying on principal or interest payable is likely to be magnified; and
- (g) the timing of changes in a Relevant Underlying may affect the actual yield to investors, even if the average level is consistent with their expectations.

### *Notes linked to a single security or index, baskets of securities or indices, to currency prices or commodity prices, to the credit of specified entities not affiliated with Morgan Stanley, Morgan Stanley Jersey or MSBV, or other assets or instruments are not ordinary debt securities*

The terms of certain Equity-Linked Notes, Commodity Notes, Currency Notes and Credit-Linked Notes differ from those of ordinary securities because such securities may not pay interest and at maturity may return less than the principal amount or nothing, or may return securities of an issuer that is not affiliated with Morgan Stanley, Morgan Stanley Jersey or MSBV, the value of which is less than the principal amount, depending on the performance of the Relevant Underlying. Prospective investors who consider purchasing the Notes should reach an investment decision only after carefully considering the suitability of the Notes in light of their particular circumstances.

***The value of Notes linked to a single security, or to baskets of securities or indices may be influenced by unpredictable factors***

The value of Equity-Linked Notes may be influenced by several factors beyond the relevant Issuer's and, where applicable, the Guarantor's control, including: (i) the market price or value of the applicable underlying security, index or basket of securities or indices, (ii) the volatility (frequency and magnitude of changes in price) of the underlying security, index or basket of securities or indices, (iii) the dividend rate on any underlying securities, (iv) geopolitical conditions and economic, financial and political, regulatory or judicial events that affect stock markets generally and which may affect the market price of the underlying security, index or basket of securities or indices, (v) interest and yield rates in the market, (vi) the time remaining to the maturity of the Notes, and (vii) the relevant Issuer's and, where applicable, the Guarantor's creditworthiness.

Some or all of these factors will influence the price investors will receive if an investor sells its Notes prior to maturity. For example, investors may have to sell certain Notes at a substantial discount from the principal amount if the market price or value of the applicable underlying security, basket of securities or index is at, below, or not sufficiently above the initial market price or value or if market interest rates rise.

***No affiliation with underlying companies***

The underlying issuer for any single security or basket security, the publisher of an underlying index, or any specified entity with respect to Credit-Linked Notes, will not be an affiliate of Morgan Stanley, Morgan Stanley Jersey or MSBV, unless otherwise specified in the applicable Final Terms. Morgan Stanley or its subsidiaries may presently or from time to time engage in business with any underlying company, or any specified entity, including entering into loans with, or making equity investments in, the underlying company, or specified entity, or its affiliates or subsidiaries or providing investment advisory services to the underlying company, or specified entity, including merger and acquisition advisory services. Moreover, no Issuer has the ability to control or predict the actions of the underlying company, index publisher, or specified entity, including any actions, or reconstitution of index components, of the type that would require the determination agent to adjust the payout to the investor at maturity. No underlying company, index publisher, or specified entity, for any issuance of Notes is involved in the offering of the Notes in any way or has any obligation to consider the investor's interest as an owner of the Notes in taking any corporate actions that might affect the value of the Notes. None of the money an investor pays for the Notes will go to the underlying company, or specified entity, for such Notes.

***Notes linked to the credit of one or more specified entities entail significant risks not associated with similar investments in conventional debt securities***

Because the payment of principal and interest on Credit-Linked Notes is contingent on the credit of one or more specified entities and such specified entities' satisfaction of their present and future financial obligations, investors will take credit risk with respect to such specified entities in addition to credit risk with respect to the relevant Issuer and, where applicable, the Guarantor. If one or more of such specified entities becomes bankrupt or subject to other insolvency procedures or fails to make payments on, repudiates or restructures any of the debt or other obligations described in the applicable Final Terms, a credit event may occur.

If a credit event occurs, the maturity of the Credit-Linked Notes will be accelerated. Upon acceleration of the Credit-Linked Notes, the investor will receive the deliverable obligations, or a cash amount calculated by reference to the value of the certain obligations, each as described in the applicable Final Terms instead of the principal amount of the Credit-Linked Notes and, if so provided in the applicable Final Terms, interest payments on the Credit-Linked Notes will cease. The market value of those deliverable obligations following a credit event will probably be significantly less than the principal amount of the

Credit-Linked Notes. Such obligations may even be worthless. Thus, if a credit event occurs, the investor may lose all of its investment in the Credit-Linked Notes.

Several factors, many of which are beyond the relevant Issuer's and, where applicable, the Guarantor's control will influence the value of the Credit-Linked Notes and the possibility of early acceleration, including: (i) the creditworthiness of the specified entity or entities underlying the Credit-Linked Notes, (ii) the relevant Issuer's and, where applicable, the Guarantor's creditworthiness and (iii) economic, financial and political events that affect the markets in which such specified entity or entities and the relevant Issuer and, where applicable, the Guarantor do business and the markets for the debt or other obligations of such specified entity or entities and of the relevant Issuer and, where applicable, the Guarantor.

***Exchange rates and exchange controls may affect Notes' value or return***

*General Exchange Rate and Exchange Control Risks.* An investment in a Note denominated in, or the payment of which is linked to the value of, currencies other than the investor's home currency entails significant risks. These risks include the possibility of significant changes in rates of exchange between its home currency and the other relevant currencies and the possibility of the imposition or modification of exchange controls by the relevant governmental authorities. These risks generally depend on economic and political events over which the Issuers have no control. Investors should consult their financial and legal advisors as to any specific risks entailed by an investment in Notes that are denominated or payable in, or the payment of which is linked to the value of, a currency other than the currency of the country in which such investor resides or in which such investor conducts its business, which is referred to as their home currency. Such Notes are not appropriate investments for investors who are not sophisticated in foreign currency transactions.

*Exchange Rates Will Affect the Investor's Investment.* In recent years, rates of exchange between some currencies have been highly volatile and this volatility may continue in the future. Fluctuations in any particular exchange rate that have occurred in the past are not necessarily indicative, however, of fluctuations that may occur during the term of any Note. Depreciation against the investor's home currency or the currency in which a Note is payable would result in a decrease in the effective yield of the Note below its coupon rate and could result in an overall loss to an investor on the basis of the investor's home currency. In addition, depending on the specific terms of a Currency-Linked Note, changes in exchange rates relating to any of the relevant currencies could result in a decrease in its effective yield and in the investor's loss of all or a substantial portion of the value of that Note.

*The Issuers Have No Control Over Exchange Rates.* Currency exchange rates can either float or be fixed. Exchange rates of most economically developed nations are permitted to fluctuate in value relative to each other. However, from time to time governments may use a variety of techniques, such as intervention by a country's central bank, the imposition of regulatory controls or taxes, or changes in interest rate to influence the exchange rates of their currencies. Governments may also issue a new currency to replace an existing currency or alter the exchange rate or relative exchange characteristics by a devaluation or revaluation of a currency. These governmental actions could change or interfere with currency valuations and currency fluctuations that would otherwise occur in response to economic forces, as well as in response to the movement of currencies across borders.

As a consequence, these government actions could adversely affect yields or payouts in the investor's home currency for (i) Notes denominated or payable in currencies other than U.S. dollars and (ii) Currency-Linked Notes.

The Issuers will not make any adjustment or change in the terms of the Notes in the event that exchange rates should become fixed, or in the event of any devaluation or revaluation or imposition of exchange or

other regulatory controls or taxes, or in the event of other developments affecting any currency. The investor will bear those risks.

*Some Currencies May Become Unavailable.* Governments have imposed from time to time, and may in the future impose, exchange controls that could also affect the availability of a Specified Currency (as defined herein). Even if there are no actual exchange controls, it is possible that the applicable currency for any security would not be available when payments on that security are due.

*Alternative Payment Method Used If Payment Currency Becomes Unavailable.* If a payment currency is unavailable in respect of Notes, Morgan Stanley would make required payments in U.S. dollars on the basis of the Market Exchange Rate (as defined below under "Description of New York Law Notes — General"). However, if the applicable currency for any Note is not available because the euro has been substituted for that currency, the relevant Issuer would make the payments in euro. Some Notes may specify a different form of payment if a non-U.S. payment currency is unavailable to the relevant Issuer.

#### ***Secondary trading of the Notes may be limited***

There may be little or no secondary market for the Notes. Although an Issuer may apply to have certain issuances of Notes admitted to listing on the Official List of the UK Listing Authority and to trading on the London Stock Exchange's regulated market for fixed income securities or admitted to listing, trading and/or quotation by any other listing authority, stock exchange and/or quotation system, approval for any listing is subject to meeting the relevant listing requirements. Even if there is a secondary market, it may not provide enough liquidity to allow the investor to sell or trade the Notes easily. Morgan Stanley & Co. International Limited currently intends to, and other affiliates of Morgan Stanley may from time to time, act as a market maker for the Notes, but they are not required to do so. If at any time Morgan Stanley & Co. International Limited and other affiliates of the Issuers were to cease acting as market makers, it is likely that there would be little or no secondary market for the Notes.

#### ***Notes may be de-listed***

If the proposed European Union Transparency Obligations Directive (the "**Directive**") is implemented in a manner which is burdensome for an Issuer or the Guarantor, the Notes may be de-listed. In such a case of de-listing, the relevant Issuer may, but is not obliged to, seek an alternative listing for the Notes on a stock exchange outside the European Union. However, if such an alternative listing is not available or is, in the opinion of the relevant Issuer or the Guarantor (if applicable), burdensome, an alternative listing for the Notes may not be considered. Although no assurance is made as to the liquidity of the Notes as a result of listing by the UK Listing Authority, de-listing the Notes may have a material effect on a Noteholder's ability to resell the Notes in the secondary market.

#### ***Investors have no shareholder rights***

As an owner of Notes, investors will not have voting rights or rights to receive dividends, interest or other distributions, as applicable, or any other rights with respect to any underlying security or index.

#### ***Exchange rates may affect the value of a judgment***

The English law Notes will be governed by, and construed in accordance with, the laws of England. Although an English court has the power to grant judgment in the currency in which a Note is denominated, it may decline to do so in its discretion. If judgment were granted in a currency other than that in which a Note is denominated, the investor will bear the relevant currency risk.

The New York Law Notes will be governed by and construed in accordance with the laws of the State of New York. If a New York court were to enter a judgment in an action on any securities denominated in a foreign currency, such court would either enter a judgment in U.S. dollars based on the prevailing rate of exchange between the foreign currency and U.S. dollars on the date such judgment is entered or enter

judgment in the foreign currency and convert the judgment or decree into U.S. dollars at the prevailing rate of exchange on the date such judgment or decree is entered.

***Potential conflicts of interest between the investor and the determination agent***

As determination agent for Notes linked to a single security or index or a basket of securities or indices, Credit-Linked Notes, or Notes linked to commodities or other underlying instruments, assets or obligations, Morgan Stanley & Co. International Limited will determine the payout to the investor at maturity. Morgan Stanley & Co. International Limited and other affiliates may also carry out hedging activities related to any Notes linked to a single security or index or a basket of securities or indices, Credit-Linked Notes, or Notes linked to commodities or to other instruments, assets or obligations including trading in the underlying securities, indices or commodities as well as in other instruments related to the underlying securities, indices or commodities. Morgan Stanley & Co. International Limited and some of Morgan Stanley's other subsidiaries may also trade the applicable underlying securities, indices or commodities and other financial instruments related to the underlying securities, indices or commodities on a regular basis as part of their general broker-dealer and other businesses. Any of these activities could influence Morgan Stanley & Co. International Limited's determination of adjustments made to any Notes linked to single securities or indices or a basket of securities or indices, Credit-Linked Notes, or Notes linked to commodities or other underlying instruments, assets or obligations and any such trading activity could potentially affect the price of the underlying securities, indices, commodities or other underlying instruments, assets or obligations and, accordingly, could affect the investor's payout on any Notes.

***The Notes may be redeemed prior to maturity***

Unless in the case of any particular Tranche of Notes the relevant Final Terms specify otherwise, in the event that the relevant Issuer would be obliged to increase the amounts payable in respect of any Notes due to any withholding or deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of any relevant jurisdiction, the relevant Issuer may redeem all outstanding Notes in accordance with the Conditions.

In addition, if in the case of any particular Tranche of Notes the relevant Final Terms specify that the Notes are redeemable at the relevant Issuer's option in certain other circumstances the relevant Issuer may choose to redeem the Notes at times when prevailing interest rates may be relatively low. In such circumstances an investor may not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as that of the relevant Notes.

In addition, an optional redemption feature in any particular Tranche of Notes is likely to limit their market value. During any period when the relevant Issuer may elect to redeem Notes, the market value of those Notes generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

***Fixed/Floating Rate Notes***

Fixed/Floating Rate Notes may bear interest at a rate that the Issuer may elect to convert from a fixed rate to a floating rate, or from a floating rate to a fixed rate. The Issuer's ability to convert the interest rate will affect the secondary market and the market value of the Notes since the Issuer may be expected to convert the rate when it is likely to produce a lower overall cost of borrowing. If the Issuer converts from a fixed rate to a floating rate, the spread on the Fixed/Floating Rate Notes may be less favourable than then prevailing spreads on comparable Floating Rate Notes tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Notes. If the Issuer converts from a floating rate to a fixed rate, the fixed rate may be lower than then prevailing rates on its Notes.

### ***Notes issued at a substantial discount or premium***

The market values of securities issued at a substantial discount or premium from their principal amount tend to fluctuate more in relation to general changes in interest rates than do prices for conventional interest-bearing securities. Generally, the longer the remaining term of the securities, the greater the price volatility as compared to conventional interest-bearing securities with comparable maturities.

***Because the Global Notes (as defined below) may be held by or on behalf of Euroclear Bank S.A./N.V. as operator of the Euroclear System ("Euroclear") and Clearstream Banking, société anonyme ("Clearstream, Luxembourg"), investors will have to rely on their procedures for transfer, payment and communication with the relevant Issuer.***

Notes issued under the Program may be represented by one or more temporary global notes (each, a **"Temporary Global Note"**) or permanent global notes (each, a **"Permanent Global Note"** and, together with a Temporary Global Note, the **"Global Notes"**). Such Global Notes may be deposited with a common depositary or common safekeeper for Euroclear and Clearstream, Luxembourg. Except in the circumstances described in the relevant Global Note, investors will not be entitled to receive definitive Notes. Euroclear and Clearstream, Luxembourg will maintain records of the beneficial interests in the Global Notes. While the Notes are represented by one or more Global Notes, investors will be able to trade their beneficial interests only through Euroclear or Clearstream, Luxembourg.

While the Notes are represented by one or more Global Notes, the Issuer will discharge its payment obligations under the Notes by making payments through Euroclear and Clearstream, Luxembourg for distribution to their account holders. A holder of a beneficial interest in a Global Note must rely on the procedures of Euroclear and Clearstream, Luxembourg to receive payments under the relevant Notes. Neither the relevant Issuer nor the Guarantor has responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in the Global Notes.

Holders of beneficial interests in the Global Notes will not have a direct right to vote in respect of the relevant Notes. Instead, such holders will be permitted to act only to the extent that they are enabled by Euroclear, Clearstream, Luxembourg to appoint appropriate proxies.

### ***Modification and waiver***

The conditions of the English Law Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

The conditions of the New York Law Notes contain provisions for Noteholder votes to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not vote and Noteholders who voted in a manner contrary to the majority.

### ***Change of law***

The conditions of the Notes are based on English law or New York law (as applicable) in effect as at the date of this Base Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law, New York law or administrative practice in England or the State of New York after the date of this Base Prospectus.



## **WHERE THE INVESTOR CAN FIND MORE INFORMATION ABOUT MORGAN STANLEY**

Morgan Stanley files annual, quarterly and current reports, proxy statements and other information with the United States Securities and Exchange Commission ("SEC"). The investor may read and copy any of these documents at the SEC's public reference room at Room 1580, 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. In addition, the SEC maintains a website that contains annual, quarterly and current reports, proxy statements and other information that Morgan Stanley files electronically. The address of the SEC's website is <http://www.sec.gov>. The information contained on this website, and any information available at the SEC's public reference room, shall not form part of this Base Prospectus, unless such information has been expressly incorporated herein by way of a supplement to this Base Prospectus.

Morgan Stanley's common stock, par value US\$0.01 per share, is listed on the New York Stock Exchange, Inc. and the Pacific Exchange, Inc. under the symbol "MS." The investor may inspect annual, quarterly and current reports, proxy statements and other information concerning Morgan Stanley and its consolidated subsidiaries at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005, and the Pacific Exchange, Inc., 115 Sansome Street, San Francisco, California 94104 (such annual, quarterly and current reports, proxy statements and other information shall not form a part of this Base Prospectus unless they have been expressly incorporated herein by way of a supplement to this Base Prospectus).

## **INCORPORATION BY REFERENCE**

The following documents shall be deemed to be incorporated in, and to form part of, this Base Prospectus, to the extent that, on or before the date of this Base Prospectus, they have been published and filed with the Financial Services Authority in its capacity as United Kingdom competent authority for the purposes of the Prospectus Directive and the relevant implementing measures in the United Kingdom:

- (i) Morgan Stanley's Quarterly Report on Form 10-Q for the quarterly period ended 28 February 2006 (as set out at <http://www.sec.gov>);
- (ii) Morgan Stanley's Proxy Statement dated 24 February 2006 (as set out at <http://www.sec.gov>);
- (iii) Morgan Stanley's Current Report on Form 8-K dated 22 February 2006 (as set out at <http://www.sec.gov>);
- (iv) Morgan Stanley's Annual Report on Form 10-K for year ended 30 November 2005 (as set out at <http://www.sec.gov>);
- (v) Morgan Stanley's Current Report on Form 8-K dated 12 October 2005 (as set out at <http://www.sec.gov>);
- (vi) Morgan Stanley's Annual Report on Form 10-K for year ended 30 November 2004 (as set out at <http://www.sec.gov>);
- (vii) Morgan Stanley Jersey's Annual Report for year ended 30 November 2004;
- (viii) Morgan Stanley Jersey's Annual Report for year ended 30 November 2005;
- (ix) MSBV's Annual Report for year ended 30 November 2004; and
- (xi) MSBV's Annual Report for year ended 30 November 2005,

save that any statement contained in this Base Prospectus or any documents incorporated by reference herein, shall be deemed to be modified or superseded for the purpose of this Base Prospectus to the extent

that a statement contained in any document subsequently incorporated by reference and in respect of which a supplement to this Base Prospectus is prepared modifies or supersedes such statement.

The information about Morgan Stanley, Morgan Stanley Jersey and MSBV incorporated by reference in this Base Prospectus, together with Morgan Stanley's Quarterly Report on Form 10-Q for the quarterly period ended 31 May 2006 which is set out in Annex A of this Base Prospectus, (the "**Incorporated Information**") is considered to be part of this Base Prospectus. Because future filings of Morgan Stanley with the SEC and future financial statements published by Morgan Stanley Jersey and MSBV are made from time to time, those future filings or financial statements, as the case may be, may modify or supersede some of the information included or incorporated by reference in this Base Prospectus. This means that investors should look at all other documents filed by Morgan Stanley with the SEC pursuant to sections 13(a), 13(c), 14 and 15(d) of the United States Securities Exchange Act of 1934 after the date of this Base Prospectus and all of the financial statements of Morgan Stanley Jersey and MSBV to determine if any of the statements in this Base Prospectus or in any document previously incorporated by reference have been modified or superseded.

The Issuers will, at their registered offices and at the specified offices of the Paying Agents, make available for inspection during normal business hours and free of charge, upon oral or written request, a copy of this Base Prospectus (or any document incorporated by reference in this Base Prospectus and any future filings or financial statements published such Issuer). Written or oral requests for inspection of such documents should be directed to the specified office of any Paying Agent.

## MORGAN STANLEY

### Auditors

The auditors of Morgan Stanley for the periods 1 December 2002 to 30 November 2003, 1 December 2003 to 30 November 2004, and 1 December 2004 to 30 November 2005 were Deloitte & Touche LLP, Two World Financial Center, New York, New York 10281, USA, an independent registered public accounting firm (the "**Auditors**").

The Auditors are registered with the Public Company Accounting Oversight Board (United States).

### Risk Factors

Information about risk factors relating to Morgan Stanley is contained in "Risk Factors" in this Base Prospectus.

### Information about Morgan Stanley

#### *History and Development of Morgan Stanley*

Morgan Stanley was originally incorporated for an unlimited term under the laws of the State of Delaware on 1 October 1981 under registered number 0923632, and its predecessor companies date back to 1924. On 31 May 1997, Morgan Stanley Group, Inc. was merged with and into Dean Witter Discover & Co. ("**Dean Witter Discover**") in a merger of equals. At that time, Dean Witter Discover changed its corporate name to Morgan Stanley, Dean Witter, Discover & Co. ("**MSDWD**"). On 24 March 1998 MSDWD changed its corporate name to Morgan Stanley Dean Witter & Co, and to Morgan Stanley on 20 June 2002. It has its registered office at The Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801, U.S.A., and its principal executive offices at 1585 Broadway, New York, New York 10036, U.S.A., telephone number +1 (212) 761-4000.

As at the date of this Base Prospectus, Morgan Stanley's legal and commercial name is "Morgan Stanley".

#### *Legislation*

Morgan Stanley is subject both to the laws of the United States of America and to the General Corporation Law of the State of Delaware ("**DGCL**"). United States federal laws affect many aspects of corporate affairs in the United States and concern such diverse matters as antitrust, bankruptcy, labor-management relations, the sale of securities and taxation. Certain United States federal securities laws are administered by the SEC and generally prohibit the sale of securities by fraudulent means and require most corporations that have issued securities, which are publicly held, such as Morgan Stanley, to make periodic financial and other reports to the SEC and to shareholders.

In the United States, business corporations are generally incorporated under the laws of one of the states. Morgan Stanley is incorporated under the laws of the State of Delaware.

Effective 1 December 2005, Morgan Stanley became a consolidated supervised entity (a "**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. As of 31 May 2006, Morgan Stanley was in compliance with the CSE capital requirements.

Morgan Stanley & Co., one of Morgan Stanley's U.S. broker-dealers, is required to hold tentative net capital in excess of U.S.\$1 billion and net capital in excess of U.S.\$500 million in accordance with the market and credit risk standards of Appendix E of Rule 15c3-1. Morgan Stanley & Co. is also required to notify the SEC in the event that its tentative net capital is less than U.S.\$5 billion. As of 31 May 2006,

Morgan Stanley & Co. had tentative net capital in excess of the minimum and the notification requirements.

Morgan Stanley continues to work with its regulators on the implementation of the CSE rules and the standards of the Basel Committee on Banking Supervision ("**Basel II**"). As rules related to Basel II are released, Morgan Stanley will consult with regulators on the new requirements. Compliance with related EU requirements (capital, oversight and reporting) will be a focus item through 2008.

#### *Recent events*

Other than as disclosed in the Incorporated Information, no recent event particular to Morgan Stanley has occurred which is to a material extent relevant to the evaluation of its solvency.

#### *Investments*

On 17 February 2006, Morgan Stanley completed the acquisition of the Goldfish credit card business ("**Goldfish**") in the U.K. from Lloyds TSB for approximately U.S.\$1,676 million. The acquisition of Goldfish added approximately 800,000 accounts and approximately U.S.\$1,316 million of receivables to Morgan Stanley's existing U.K. credit card business. Since the acquisition date, the results of Goldfish have been included within the Discover business segment. Morgan Stanley recorded goodwill and other intangible assets of approximately U.S.\$355 million in connection with the acquisition. The acquisition price is still subject to finalization, and the allocation of the price is preliminary and is subject to further adjustment as the valuation of certain intangible assets is still in process.

Except as disclosed herein and in the Incorporated Information, so far as Morgan Stanley is aware, there have been no material investments made since the date of its last published financial statements and there are no principal future investments to which Morgan Stanley's management have already made firm commitments.

### **Business Overview**

#### *Principal Activities*

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, Asset Management and Discover. Morgan Stanley, 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. A summary of the activities of each of the segments follows:

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

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

*Asset Management* provides global asset management products and services in equities, fixed income and alternative investment products through three principal distribution channels: a proprietary channel consisting of Morgan Stanley's representatives; a non-proprietary channel consisting of third-party broker-dealers, banks, financial planners and other intermediaries; Morgan Stanley's institutional sales channel; and engages in investment activities.

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

#### *Principal Markets*

Morgan Stanley conducts its business from its headquarters in 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.

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, 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 costs.

*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, brokers and dealers, and with others on a regional or product basis. Morgan Stanley competes 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.

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 and Morgan Stanley expects this activity to continue in the future.

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 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 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 that may enhance their competitive position and could result in pricing pressure in Morgan Stanley's 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 trades electronically through the internet and other alternative trading systems has increased the pressure on trading commissions. The trend toward the use of alternative trading systems 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 products compete with the funds and separately managed account products of other asset management firms and other investment alternatives, including hedge funds.

*Discover:* Discover competes directly with other bank-issued credit cards (the vast majority of which bear the MasterCard or Visa servicemark), charge cards, credit cards issued by travel and financial advisory companies and debit cards. Credit cards that may be issued on the Discover Network by other financial institutions may also compete with credit cards offered by Discover through Discover Bank. Competition centers on merchant acceptance of credit and debit cards, account acquisition and customer utilization of credit and debit cards. Merchant acceptance is based on competitive transaction pricing and the volume and usage of cards in circulation. Credit card account acquisition and customer utilization are driven by competitive and appealing credit card features, such as no annual fees, low introductory interest rates and other customized features targeting specific consumer groups. Credit card industry participants have increasingly used advertising, targeted marketing, account acquisitions and pricing competition in interest rates, annual fees, reward programs and low-priced balance transfer programs to compete and grow.

The Discover Network competes with other card networks, including among others, VISA, MasterCard and American Express. The principal competitive factors that affect the network business include the number of cards in force and amount of spending on these cards, the quantity and quality of places where cards can be used, the economic attractiveness to card issuers and merchants participating in the network, reputation and brand recognition, innovation in systems, technology and product offerings, and quality of customer service.

### **Organisational Structure**

Morgan Stanley is a holding company that provides its products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals, through its subsidiaries and affiliates.

Morgan Stanley's U.S. and international subsidiaries include Morgan Stanley & Co. Incorporated, Morgan Stanley & Co. International Limited, Morgan Stanley Japan Limited, Morgan Stanley DW Inc., Morgan Stanley Investment Advisors Inc. and NOVUS Credit Services Inc.

### **Trend Information**

There has been no significant change in the financial or trading position of Morgan Stanley and its consolidated subsidiaries since 31 May 2006.

## Management

### *Directors*

The directors of Morgan Stanley as of the date of this Base Prospectus, their offices, if any, within Morgan Stanley, and their principal outside activity, if any, are listed below. The business address of each director is 1585 Broadway, New York, New York 10036, USA.

<b>Name</b>	<b>Function within Morgan Stanley</b>	<b>Principal Outside Activity</b>
John J. Mack	Chairman of the Board and Chief Executive Officer	John J. Mack does not perform other relevant managerial activities outside Morgan Stanley
Roy J. Bostock	Director	Director of Northwest Airlines Corporation and Yahoo! Inc.
Erskine B. Bowles	Director	President of the University of North Carolina, Director of General Motors Corporation and Cousins Properties Inc.
Sir Howard J. Davies	Director	Director of the London School of Economics and Political Science
C. Robert Kidder	Lead Director	Principal of Stonehenge Partners, Inc., Director of Schering-Plough Corporation
Donald T. Nicolaisen	Director	Director of Verizon Communications Inc.
Charles H. Noski	Director	Director of Microsoft Corporation and Air Products and Chemicals Inc.
Hutham S. Olayan	Director	President, Chief Executive Officer and Director of Olayan America Corporation, the Americas-based arm of The Olayan Group (since 1985). Director of the Olayan Group.
Charles E. Phillips	Director	President of Oracle Corporation, Director of Viacom, Inc.
O. Griffith Sexton	Director	Adjunct Professor at Columbia Business School and visiting lecturer at Princeton University, Advisory director of Morgan Stanley, Director of Investor AB
Dr. Laura D. Tyson	Director	Dean of the London Business School, Director of Eastman Kodak

<b>Name</b>	<b>Function within Morgan Stanley</b>	<b>Principal Outside Activity</b>
		Company and AT&T Inc.
Dr. Klaus Zumwinkel	Director	Chairman of the Board of Management, Deutsche Post AG, Director of Deutsche Lufthansa AG (Supervisory Board), Deutsche Telekom AG (Chairman, Supervisory Board), Karstadt Quelle AG (Supervisory Board) and Deutsche Postbank AG (Chairman, Supervisory Board)

### **Related Party Transactions**

During fiscal year 2005, Morgan Stanley's subsidiaries extended credit in the ordinary course of business to certain of Morgan Stanley's directors, officers and employees and members of their immediate families. These extensions of credit were in connection with margin loans, mortgage loans, credit card transactions, revolving lines of credit and other extensions of credit by Morgan Stanley's subsidiaries. The extensions of credit were made on substantially the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with other persons. The extensions did not involve more than the normal risk of collectability or present other unfavorable features. Directors, officers and employees and members of their immediate families who wish to purchase securities and derivative and financial products and financial services may do so through Morgan Stanley's subsidiaries. These subsidiaries may offer them discounts on their standard commission rates or fees. These subsidiaries also, from time to time and in the ordinary course of their business, enter into transactions on a principal basis involving the purchase or sale of securities and derivative products in which Morgan Stanley's directors, officers and employees and members of their immediate families have an interest. These purchases and sales may be made at a discount from the dealer mark-up or mark-down, as the case may be, charged to non-affiliated third parties. Certain employees, including Morgan Stanley's executive officers, may invest on the same terms and conditions as other investors in investment funds that Morgan Stanley may form and manage primarily for client investment, except that Morgan Stanley may waive or lower certain fees and expenses for its employees. In addition, Morgan Stanley may, pursuant to stock repurchase authorizations in effect from time to time, repurchase or acquire shares of Morgan Stanley's common stock in the open market or in privately negotiated transactions, which may include transactions with directors, officers and employees. These transactions are in the ordinary course of business and at prevailing market prices.

During fiscal 2005, Morgan Stanley engaged in transactions in the ordinary course of business with each of State Street and Barclays and certain of their respective affiliates. Each of State Street and Barclays beneficially owned more than 5% of the outstanding shares of Morgan Stanley common stock as of December 31, 2005. Such transactions were on substantially the same terms as those prevailing at the time for comparable transactions with unrelated third parties. Morgan Stanley also engages in transactions, including entering into financial services transactions (e.g., trading in securities, commodities or derivatives) with, and perform investment banking, financial advisory, brokerage, investment management and other services for, entities for which the directors and members of their immediate family serve as executive officers, and may make loans or commitments to extend loans to such entities. The transactions are conducted, services are performed, and loans and commitments are made in the ordinary course of business and on substantially the same terms, including interest rate and



collateral, that prevail at the time for comparable transactions with other persons. The loans do not involve more than the normal risk of collectability or present other unfavourable features.

There are no existing or potential conflicts of interest between any duties owed to Morgan Stanley by its directors or by the members of its principal committees and the private interests and/or other external duties owed by these individuals.

### ***Board Practice***

Morgan Stanley considers itself to be in compliance with all United States laws relating to corporate governance that are applicable to it.

The Board meets regularly and directors receive information between meetings about the activities of committees and developments in Morgan Stanley's business. All directors have full and timely access to all relevant information and may take independent professional advice if necessary.

The Corporate Governance Policies (including Morgan Stanley's standards of director independence), Code of Ethics and Business Conduct, Board Committee charters, Policy regarding Communication by Shareholders and other Interested Parties with the Board of Directors, Policy regarding Director Candidates Recommended by Shareholders, Policy regarding Corporate Political Contributions, Procedures for Reporting, Auditing and Accounting Concerns and the Management Committee Equity Ownership Commitment are available at Morgan Stanley's corporate governance webpage at the "Inside the Company" link under the "About Morgan Stanley" link at "<http://www.morganstanley.com/about/inside/governance>". The information contained on this webpage, shall not form part of this Base Prospectus, unless such information has been expressly incorporated herein by way of a supplement to this Base Prospectus.

The Board's standing committees include the following:

<b>Committee</b>	<b>Current Members</b>	<b>Primary Responsibilities</b>
Audit	Charles H. Noski (Chair)  Sir Howard J. Davies  Donald T. Nicolaisen	Oversees the integrity of Morgan Stanley's consolidated financial statements, system of internal controls, system of risk management and system of compliance with legal and regulatory requirements.  Selects, determines the compensation of, evaluates and, when appropriate, replaces the independent auditor, and pre-approves audit and permitted non-audit services.  Oversees the qualifications and independence of the independent auditor and performance of Morgan Stanley's internal and independent auditors.
Compensation,  Management,  Development and  Succession	C. Robert Kidder (Chair)  Erskine B. Bowles	Annually reviews and approves the corporate goals and objectives relevant to the compensation of the Chairman and CEO and evaluates his performance in light of these goals and objectives.

Committee	Current Members	Primary Responsibilities
		<p>Determines the compensation of Morgan Stanley's executive officers and other appropriate officers.</p> <p>Administers Morgan Stanley's incentive and equity-based compensation plans.</p> <p>Oversees plans for management development and succession</p>
Nominating and Governance	<p>Dr. Laura D. Tyson (Chair)</p> <p>Roy J. Bostock</p> <p>Hutham S. Olayan</p> <p>Dr. Klaus Zumwinkel</p>	<p>Identifies and recommends candidates for election to the Board.</p> <p>Establishes procedures for its oversight of the evaluation of the Board and management.</p> <p>Recommends director compensation and benefits.</p> <p>Reviews annually Morgan Stanley's corporate governance policies.</p> <p>Assists in monitoring Morgan Stanley's compliance with legal and regulatory requirements.</p>

### *Employees*

As at 31 May 2006, Morgan Stanley had 53,163 employees worldwide.

### **Principal Shareholders**

Under SEC regulations applicable to Morgan Stanley, the relevant threshold for disclosure obligation concerning participation interests in listed companies is 5 per cent. of share capital. Therefore, this is the only information available to the public.

Morgan Stanley does not have information about shareholders with participation interests between 2 per cent. and 5 per cent. According to the most recent SEC filings, as at 24 February 2006, the following shareholders owned more than 5 per cent. of Morgan Stanley's common stock:

Name and Address	Shares of Common Stock Beneficially Owned	
	Number	per cent.(1)
State Street Bank and Trust Company(2) 225 Franklin Street, Boston, MA 02110	88,782,390	8.3%
Barclays Global Investors, N.A., and other reporting entities(3) 45 Fremont Street, San Francisco, CA 94105	64,581,639	6.0%

(1) Percentages calculated based upon common stock outstanding as of February 3, 2006 and holdings of common stock set forth in the Schedule 13G Information Statements described in notes 2-3 below. These Information Statements state that State Street and Barclays beneficially owned 8.4% and 6.1%, respectively, of Morgan Stanley's common stock on December 31, 2005.

(2) Based on Schedule 13G Information Statement filed February 14, 2006 by State Street, acting in various fiduciary capacities. The Schedule 13G discloses that State Street had sole voting power as to 29,244,065 shares, shared voting power as to 59,538,325 shares, sole dispositive power as to no shares and shared dispositive power as to 88,782,390 shares; that shares held by State Street on behalf of the Trust and Company-sponsored equity-based compensation program amounted to 5.65% of the common stock as of December 31, 2005; and that State Street disclaimed beneficial ownership of all shares reported therein.

(3) Based on a Schedule 13G Information Statement filed on January 26, 2006 by Barclays Global Investors, N.A., Barclays Global Fund Advisors, Barclays Global Investors, Ltd, Barclays Global Investors Japan Trust and Banking Company Limited. In the Schedule 13G, the reporting entities do not affirm the existence of a group. The Schedule 13G discloses that the reporting entities, taken as a whole, had sole voting and sole dispositive power as to 56,379,426 shares and 64,581,639 shares, respectively, and did not have shared power as to any shares.

Accordingly, there is no entity owning or controlling, either directly or indirectly, Morgan Stanley.

### Share Capital

The authorised share capital of Morgan Stanley at 31 May 2006 comprised 3,500,000,000 ordinary shares of nominal value U.S.\$0.01.

The issued, non-assessable and fully paid up share capital of Morgan Stanley at 31 May 2006 comprised 1,211,701,552 ordinary shares of nominal value U.S.\$0.01.

### Certificate of Incorporation

Morgan Stanley's objects and purposes are set out on page 1 of its Certificate of Incorporation and enable it to engage in any lawful act or activity for which corporations may be organised and incorporated under the DGCL.

## **Selected Financial Information**

The Selected Financial Information relevant for this Base Prospectus can be found on page 32 of Morgan Stanley's Annual Report on Form 10-K for the year ended 30 November 2005, on page 27 of Morgan Stanley's Annual Report on Form 10-K for the year ended 30 November 2004, on page 6 of Morgan Stanley's Quarterly Report on Form 10-Q for the quarterly period ended 28 February 2006, and on page 5 of Morgan Stanley's Quarterly Report on Form 10-Q for the quarterly period ended 31 May 2006. All of these documents (except for Form 10-Q for the quarterly period ended 31 May 2006) have been incorporated by reference into this Base Prospectus as set out under "Incorporation by Reference". Form 10-Q for the quarterly period ended 31 May 2006 is set out in Annex A of this Base Prospectus.

## **Financial Information**

Financial information relating to Morgan Stanley is contained in the Forms 10-K of Morgan Stanley for the fiscal years ended 30 November 2005 and 30 November 2004, respectively, Form 10-Q for the quarterly period ended 28 February 2006, Forms 8-K dated 22 February 2006 and 12 October 2005 and the proxy statement dated 24 February 2006, which are incorporated by reference into this Base Prospectus as set out in "Incorporation by Reference", and in Form 10-Q for the quarterly period ended 31 May 2006 which is set out in Annex A of this Base Prospectus (the "**Financial Information**").

There has been no material adverse change in the prospects of Morgan Stanley and its consolidated subsidiaries since 30 November 2005.

### *Auditing of Historical Financial Information*

The Auditors have audited in accordance with the standards of the Public Company Accounting Oversight Board (United States) (i) the consolidated statements of financial condition of Morgan Stanley as of 30 November 2005 and 2004 and the related consolidated statements of income, comprehensive income, cash flows and changes in shareholders' equity for each of three years in the period ended 30 November 2005; (ii) the related financial statement schedule included in Schedule I and (iii) management's report of the effectiveness of internal control over financial reporting, (which reports on the financial statements and financial statement schedule each express an unqualified opinion and include an explanatory paragraph relating to the adoption in 2005 of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" and, in the case of the report on the financial statements, the change in classification of repurchase transactions in the consolidated statements of cash flows), appearing in Morgan Stanley's Annual Report on Form 10-K for the year ended November 2005.

### *Legal and Arbitration Proceedings*

Except for the legal proceedings referred to under Part I. Item 3. "Legal Proceedings" in Morgan Stanley's Annual Report on Form 10-K for the year ended 30 November 2005 (pages 24-29) and under Part II. Item 1. "Legal Proceedings" in Morgan Stanley's Quarterly Report on Form 10-Q for the quarterly period ended 28 February 2006 (page 78), which are incorporated by reference into this Base Prospectus as set out under "Incorporation by Reference", and under Part II. Item 1. "Legal Proceedings" in Morgan Stanley's Quarterly Report on Form 10-Q for the quarterly period ended 31 May 2006 (pages 85-87), which is set out in Annex A of this Base Prospectus, there are no, nor have there been any, legal, governmental or arbitration proceedings (including any such proceedings which are pending or threatened of which Morgan Stanley is aware during the 12 month period before the date of this Base Prospectus) involving Morgan Stanley or any of its consolidated subsidiaries which may have or have had in the recent past, a significant effect on Morgan Stanley's consolidated financial position or profitability. Morgan Stanley's Annual Report on Form 10-K for the year ended 30 November 2005 and Quarterly Reports on Form 10-Q for the quarterly periods ended 28 February 2006 and 31 May 2006, respectively,

have been deposited with the Financial Services Authority pursuant to Article 11 of the Prospectus Directive and its relevant implementing measures in connection with the approval of the Base Prospectus.

## **MORGAN STANLEY JERSEY**

### **History and Development**

Morgan Stanley (Jersey) Limited was incorporated in St. Helier, Jersey, Channel Islands (registration number 35857) as a company with unlimited duration on 24 September 1986. It has its registered office at 22 Grenville Street, St. Helier, Jersey JE4 8PX, Channel Islands, telephone number +44 (0)1534 609000.

### **Legislation**

Morgan Stanley Jersey is subject to the Companies (Jersey) Law 1991, as amended.

### **Investments**

All material assets of Morgan Stanley Jersey are obligations of (or securities issued by) one or more Morgan Stanley group companies.

### **Principal Activities**

Morgan Stanley Jersey's business primarily consists of issuing financial instruments and the hedging of obligations relating thereto.

### **Principal Markets**

Morgan Stanley Jersey conducts its business from Jersey. All material assets of Morgan Stanley Jersey are obligations of (or securities issued by) one or more Morgan Stanley group companies. Morgan Stanley Jersey does not undertake such business on a competitive basis, however as a member of the Morgan Stanley group it is indirectly affected by some of the competitive pressures that apply to Morgan Stanley. See "Morgan Stanley" above for further details.

### **Organisational Structure**

Morgan Stanley Jersey has no subsidiaries. It is wholly owned by Morgan Stanley.

### **Trend Information**

Morgan Stanley Jersey intends to continue issuing securities and entering hedges in respect of such issues of securities.

There has been no significant change in the financial or trading position, nor any material adverse change in the prospects of, Morgan Stanley Jersey since 30 November 2005.

### **Management**

The directors of Morgan Stanley Jersey, their respective business addresses and principal outside activities as at the date hereof are:

#### *Name and Business Address*

Joel Hodes  
Morgan Stanley  
1585 Broadway  
New York, New York 10920  
U.S.A.

#### *Principal Outside Activity*

Managing Director, Morgan Stanley

Charles Edward Crossley Hood  
Morgan Stanley  
25 Cabot Square  
Canary Wharf  
London E14 4QA

Managing Director, Morgan Stanley

John Roberts  
Morgan Stanley  
25 Cabot Square  
Canary Wharf  
London E14 4QA

Managing Director, Financing Products Group  
Morgan Stanley

John Roberts has given notice of his intention to resign as a director of Morgan Stanley Jersey.

There are no existing or potential conflicts of interest between any duties owed to Morgan Stanley Jersey by its management (as described above) and the private interests and/or other external duties owed by these individuals.

The secretary of Morgan Stanley Jersey is Maurant & Co. Secretaries Limited of 22 Grenville Street, St. Helier, Jersey JE4 8PX, Channel Islands.

#### **Board Practice**

Morgan Stanley Jersey considers itself to be in compliance with all Jersey laws relating to corporate governance that are applicable to it.

As of the date of this Base Prospectus, Morgan Stanley Jersey does not have an audit committee.

#### **Shareholders**

Morgan Stanley Jersey is wholly owned by Morgan Stanley. Morgan Stanley Jersey is not aware of any control measures with respect to such shareholder control. All decisions to issue securities are taken by the Board and Morgan Stanley Jersey earns a spread on all its issues of securities.

#### **Share Capital**

The authorised share capital of Morgan Stanley Jersey comprises 10,000 ordinary shares of nominal value GBP1.

The issued, allotted and fully paid up share capital of Morgan Stanley Jersey comprises 10,000 ordinary shares of nominal value GBP1.

#### **Memorandum and Articles of Association**

Morgan Stanley Jersey's objects and purposes are not specified in any document and are therefore unlimited.

#### **Selected Financial Information**

The (loss) / profit before tax for the financial years ended November 2005 and 2004 was nil and U.S.\$(16,000) respectively. The current assets of Morgan Stanley Jersey have fallen from U.S.\$4,758,540,000 in 2004 to U.S.\$3,598,223,000 in 2005 with total creditors falling from U.S.\$4,758,084,000 in 2004 to U.S.\$3,597,767,000 in 2005.

## **MSBV**

### **History and Development**

Morgan Stanley B.V. was incorporated as a private limited company under the laws of The Netherlands on 6 September 2001 for an unlimited duration. MSBV is registered at the commercial register of the Chamber of Commerce and Industries for Amsterdam under registered number 34161590 with registered offices at Locatellikade 1, 1076 AZ Amsterdam, The Netherlands, telephone number +31 20 57 55 600.

### **Legislation**

MSBV is incorporated under, and subject to, the laws of The Netherlands.

### **Investments**

All material assets of MSBV are obligations of (or securities issued by) one or more Morgan Stanley group companies.

### **Principal Activities**

MSBV's objects are, inter alia, to issue notes, warrants and other securities.

### **Principal Markets**

MSBV conducts its business from the Netherlands. All material assets of MSBV are obligations of (or securities issued by) one or more Morgan Stanley group companies. MSBV does not undertake such business on a competitive basis, however as a member of the Morgan Stanley group it is indirectly affected by some of the competitive pressures that apply to Morgan Stanley. See "Morgan Stanley" above for further details.

### **Organisational Structure**

MSBV has no subsidiaries. It is ultimately controlled by Morgan Stanley.

### **Trend Information**

MSBV intends to continue issuing securities and entering hedges in respect of such issues of securities.

There has been no significant change in the financial or trading position, nor any material adverse change in the prospects, of MSBV since 30 November 2005.

### **Management**

The current directors of MSBV, their offices, if any, within MSBV, and their principal outside activity, if any, are listed below. The business address of each director is Locatellikade 1, 1076 AZ Amsterdam, The Netherlands.

<i>Name</i>	<i>Title</i>	<i>Principal Outside Activity</i>
C.E.C. Hood	Managing Director	Managing Director, Morgan Stanley
J. Solan	Executive Director	Executive Director, Morgan Stanley
G.C. De Boer	Managing Director	Executive Director and Sales Director, Morgan Stanley Investment



## Management

TMF Management B.V.                      Managing Director

### **Directors of TMF Management B.V.**

R.W. de Koning	Managing Director	Employee of TMF Nederland B.V.
F.A.J. van Oers	Managing Director	Employee of TMF Nederland B.V.
T.J. van Rijn	Managing Director	Employee of TMF Nederland B.V.
R.A. Rijntjes	Managing Director	Employee of TMF Nederland B.V.
M.C. van der Sluijs-Plantz	Managing Director	Employee of TMF Nederland B.V.
J.R. de Vos van Steenwijk	Managing Director	Employee of TMF Nederland B.V.
J. Versluis	Managing Director	Employee of TMF Nederland B.V.
R.A.M. van de Voort	Managing Director	Employee of TMF Nederland B.V.

There are no existing or potential conflicts of interest between any duties owed to MSBV by its management (as described above) and the private interests and/or other external duties owed by these individuals.

### **Board Practice**

MSBV considers itself to be in compliance with all Netherlands laws relating to corporate governance that are applicable to it.

As of the date of this Base Prospectus, MSBV does not have an audit committee.

### **Shareholders**

MSBV is ultimately controlled by Morgan Stanley. MSBV is not aware of any control measures with respect to such shareholder control. All decisions to issue securities are taken by the Board and MSBV earns a spread on all its issues of securities.

### **Share Capital**

The authorised share capital of MSBV comprises 900 ordinary shares of nominal value EUR100.

The issued, allotted and fully paid up share capital of MSBV comprises 180 ordinary shares of nominal value EUR100.

### **Memorandum and Articles of Association**

MSBV's objects and purposes are set out in its Articles of Association and enable it to issue, sell, purchase, transfer and accept warrants, derivatives, certificates, debt securities, equity securities and/or similar securities or instruments and to enter into hedging arrangements in connection with such securities and instruments. Furthermore its objects are to finance businesses and companies, to borrow, to lend and to raise funds as well as to enter into agreements in connection with the aforementioned, to render guarantees, to bind the company and to pledge its assets for obligations of the companies and enterprises

with which it forms a group and on behalf of third parties and to trade in currencies, securities and items of property in general.

### **Selected Financial Information**

The net revenue for the financial years ended 30 November 2005 and 2004 was EUR 1,614,000 and EUR 3,638,000 respectively, representing issuance fees received on the issuance of financial instruments less guarantee fees payable. The (loss)/profit before tax for the financial years ended 30 November 2005 and 2004 was EUR (1,475,000) and EUR 3,660,000 respectively. The current assets of MSBV have risen from EUR 415,715,000 in 2004 to EUR 641,974,000 in 2005 with total creditors rising from EUR 126,158,000 to EUR 636,732,000 in 2005. The principal reason for the increase in issuances is an increase in client demand for financial instruments.

## KEY FEATURES OF NEW YORK LAW NOTES

*The following summary describes the key features of the New York Law Notes that Morgan Stanley is offering under the Program in general terms only. Investors should read the summary together with the more detailed information that is contained in this Securities Note and in the applicable Final Terms*

<b>Issuer</b> .....	Morgan Stanley.
<b>Distribution Agents</b> .....	Morgan Stanley & Co. International Limited and Morgan Stanley & Co. Incorporated.
<b>Trustee</b> .....	JPMorgan Chase Bank, N.A. (formerly known as The Chase Manhattan Bank), London Branch.
<b>Principal Paying Agent</b> .....	JPMorgan Chase Bank, N.A., London Branch.
<b>Irish Paying Agent</b> .....	J.P. Morgan Bank (Ireland) plc.
<b>Program Amount</b> .....	U.S.\$ 20,000,000,000 or the equivalent amount thereof in other currencies. The maximum aggregate amount of Notes permitted to be outstanding at any one time under the Program may be increased from time to time.
<b>General Terms of the Notes</b> .....	<ul style="list-style-type: none"> <li>• Final Terms will be produced in relation to each Tranche of Notes issued by Morgan Stanley (each a "<b>Final Terms</b>").</li> <li>• The Notes will bear interest at either a fixed rate or a floating rate, which, in either case, may be zero, or at a rate which varies during the lifetime of the relevant Notes, which will be specified in the applicable Final Terms.</li> <li>• The Notes will mature on the dates specified in the applicable Final Terms.</li> <li>• The Notes may be either callable by Morgan Stanley or puttable by the holder of the Notes (the "<b>Noteholder</b>").</li> <li>• The Notes may be optionally or mandatorily exchangeable for securities of an issuer that is not affiliated with Morgan Stanley, for a basket or index of those securities or for the cash value of those securities ("<b>Exchangeable Notes</b>").</li> <li>• Payments of principal, interest and/or supplemental amounts on the Notes may be linked to the credit of one or more specified entities not affiliated with Morgan Stanley ("<b>Credit-Linked Notes</b>"), to currency prices ("<b>Currency-Linked Notes</b>"), to commodity prices ("<b>Commodity-Linked Notes</b>") or to single securities, baskets of securities or indices</li> </ul>

**("Equity-Linked Notes").**

- Morgan Stanley may from time to time, without the consent of Noteholders, create and issue additional Notes having the same terms as Notes previously issued so that they may be combined with the earlier issuance.
- All of the New York Law Notes issued under the Program will constitute a single series for purposes of certain votes required under the Indenture.
- Morgan Stanley may issue Amortizing Notes (as defined herein) that pay a level amount in respect of both interest and principal amortized over the life of the Notes.

**Forms of Notes** ..... Morgan Stanley will issue Notes in bearer form, which may be in either definitive form or global form. Notes in definitive bearer form will be serially numbered. See "Forms of Notes" below.

Notes issued with maturities of more than 183 days initially will be represented by a temporary global bearer note that Morgan Stanley will deposit with a common depositary or (if in New Global Note form) a common safekeeper for Euroclear Bank S.A./N.V., as operator of the Euroclear System ("**Euroclear**"), Clearstream Banking, *société anonyme*, Luxembourg ("**Clearstream, Luxembourg**"), and/or any other relevant clearing system. Interests in each temporary global bearer note will be exchangeable for interests in permanent global bearer notes or for definitive bearer notes.

Notes issued with maturities of 183 days or less initially will be represented by a permanent global bearer note that Morgan Stanley will deposit with a common depositary or (if in New Global Note form) a common safekeeper for Euroclear, Clearstream, Luxembourg, and/or any other relevant clearing system.

**Specified Currency** ..... Notes may be denominated or payable in any currency, as set out in the applicable Final Terms, subject to all applicable consents being obtained and compliance with all applicable legal and regulatory requirements.

**Status** ..... Notes will be direct and general obligations of Morgan Stanley.

**Issue Price** ..... Notes may be issued at any price as specified in the applicable Final Terms.

<b>Maturities</b> .....	Notes will have maturities as specified in the applicable Final Terms, subject to compliance with all applicable legal and regulatory requirements.  Where Notes have a maturity of less than one year and either (a) the issue proceeds are received by Morgan Stanley in the United Kingdom or (b) the activity of issuing the Notes is carried on from an establishment maintained by Morgan Stanley in the United Kingdom, such Notes must: (i) have a minimum redemption value of £100,000 (or its equivalent in other currencies) and be issued only to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses; or (ii) be issued in other circumstances which do not constitute a contravention of section 19 of the Financial Services and Markets Act 2000 ("FSMA") by Morgan Stanley.
<b>Redemption</b> .....	Notes may be redeemed at par or at such other redemption amount (detailed in a formula or otherwise) or by the delivery of securities of an issuer that is not affiliated with Morgan Stanley, as may be specified in the applicable Final Terms.
<b>Early Redemption</b> .....	Early redemption will be permitted for taxation reasons as described in "Description of New York Law Notes—Tax Redemption," but will otherwise be permitted only to the extent specified in the applicable Final Terms.
<b>Denominations</b> .....	Notes will be issued in such denominations as may be specified in the applicable Final Terms, subject to compliance with all applicable legal and regulatory requirements.
<b>Taxation</b> .....	Payments in respect of the Notes will be made without withholding or deduction for, or on account of, any present or future Taxes (as defined herein) imposed or levied by or on behalf of the United States or any respective political subdivision thereof or any authority or agency therein or thereof having power to tax, unless the withholding or deduction of those Taxes is required by law. In that event, Morgan Stanley will (subject to customary exceptions) pay those Additional Amounts (as defined herein) as will result in the Noteholders receiving those amounts as they would have received in respect of the Notes had no withholding or deduction been required.
<b>Use of Proceeds</b> .....	The net proceeds from the sale of Notes offered by this Base Prospectus will be used by Morgan Stanley for

general corporate purposes, in connection with hedging its obligations under the Notes, or both.

**Listing**..... Applications have been made to admit the Series A Notes offered under the Program by Morgan Stanley to the Official List of the UK Listing Authority and to trading on the regulated market for gilt edged and fixed income securities of the London Stock Exchange. The applicable Final Terms will specify whether an issue of Series A Notes will be admitted to the Official List of the UK Listing Authority and to trading on the regulated market for gilt edged and fixed income securities of the London Stock Exchange or admitted to listing, trading and/or quotation by any other listing authority, stock exchange and/or quotation system as Morgan Stanley and any Distribution Agent may agree. The Series B Notes will not be listed on any exchange.

If the proposed European Union Transparency Obligations Directive (the “**Directive**”) is implemented in a manner which is burdensome for an Issuer or the Guarantor, the Notes may be de-listed. In such a case of de-listing, the relevant Issuer may, but is not obliged to, seek an alternative listing for the Notes on a stock exchange outside the European Union. However, if such an alternative listing is not available or is, in the opinion of the relevant Issuer or the Guarantor (if applicable), burdensome, an alternative listing for the Notes may not be considered. Although no assurance is made as to the liquidity of the Notes as a result of listing by the UK Listing Authority, de-listing the Notes may have a material effect on a Noteholder’s ability to resell the Notes in the secondary market.

**Clearing Systems** ..... Euroclear, Clearstream, Luxembourg, and/or any other clearing system as may be specified in the applicable Final Terms.

**Governing Law** ..... If so indicated in the applicable Final Terms, the Notes will be governed by the laws of the State of New York.

**Selling Restrictions** ..... **The Notes may not be offered, sold or delivered at any time, directly or indirectly, within the United States or to or for the account of U.S. Persons (as defined in either Regulation S under the Securities Act or the United States Internal Revenue Code of 1986, as amended (the "Code")).** For a description of certain restrictions on offers, sales and deliveries of the Notes and on the distribution of offering material in the United States and in certain other countries, see "Subscription and Sale" and "No Ownership by U.S. Persons."

## KEY FEATURES OF THE ENGLISH LAW NOTES

*The following summary describes the key features of the English Law Notes that each Issuer is offering under the Program in general terms only. Investors should read the summary together with the more detailed information that is contained in this Base Prospectus and in the applicable Final Terms.*

<b>Issuers</b> .....	Morgan Stanley, Morgan Stanley Jersey, MSBV and any Additional Issuer
<b>Guarantor</b> .....	In the case of Notes issued by Morgan Stanley Jersey, MSBV or an Additional Issuer, unless specified otherwise in the applicable Final Terms or, in the case of an Additional Issuer, the accession agreement pursuant to which such Additional Issuer accedes to the Program, Morgan Stanley
<b>Distribution Agents</b> .....	Morgan Stanley & Co. International Limited and Morgan Stanley & Co. Incorporated
<b>Fiscal Agent</b> .....	JPMorgan Chase Bank, N.A., London Branch
<b>Irish Paying Agent</b> .....	J.P. Morgan Bank (Ireland) plc.
<b>Program Amount</b> .....	U.S.\$20,000,000,000 or the equivalent amount thereof in other currencies. The maximum aggregate amount of Notes permitted to be outstanding at any one time under this Program may be increased from time to time.
<b>Issuance in Series</b> .....	Notes will be issued in series (each, a " <b>Series</b> "). Each Series may comprise one or more tranches (" <b>Tranches</b> " and each, a " <b>Tranche</b> ") issued on different issue dates. The Notes of each Series will all be subject to identical terms, except that the issue date and the amount of the first payment of interest may be different in respect of different Tranches and each Series may comprise Notes of different denominations. The Notes of each Tranche will all be subject to identical terms in all respects save that a Tranche may comprise Notes of different denominations.
<b>Forms of Notes</b> .....	Each Issuer will issue Notes in bearer form, which may be in either definitive form or global form. Notes in definitive bearer form will be serially numbered. See "Forms of Notes" below.

Notes issued with maturities of more than 183 days initially will be represented by a temporary global bearer note that the relevant Issuer will deposit (in the case of a temporary global note in New Global Note form) with a common safekeeper, and otherwise with a common depositary for Euroclear, Clearstream, Luxembourg, and/or any other relevant clearing system. Interests in each temporary global bearer note will be exchangeable for interests in permanent global bearer notes or for definitive bearer notes.

Notes issued with maturities of 183 days or less initially will be represented by a permanent global bearer note that the relevant Issuer will deposit with (in the case of a temporary global note in New Global Note form) a common safekeeper, and otherwise with a common depositary for Euroclear, Clearstream, Luxembourg, and/or any other relevant clearing system.

**Terms and Conditions** ..... A Final Terms will be prepared in respect of each Tranche of Notes (each, a "**Final Terms**"). The terms and conditions applicable to each Tranche will be those set out herein under the heading "Terms and Conditions of the English Law Notes", as supplemented, modified or replaced, in each case, by the applicable Final Terms. The terms and conditions applicable to each Tranche issued by an Additional Issuer will be those set out in the relevant Supplemental Base Prospectus, as supplemented, modified or replaced by the applicable Final Terms.

Any Issuer may issue Notes that are Equity-Linked Notes, Commodity Notes, Currency Notes, or Credit-Linked Notes (each as defined in Condition 9 (*Equity-Linked, Commodity, Currency, and Credit-Linked Notes*) of "Terms and Conditions of the English Law Notes").

**Specified Currency** ..... Notes may be denominated or payable in any currency as set out in the applicable Final Terms, subject to all applicable consents being obtained and compliance with all applicable legal and regulatory requirements.

**Status** ..... Notes will be direct and general obligations of the relevant Issuer.



<b>Guarantee</b> .....	The payment of all amounts due in respect of Notes issued by Morgan Stanley Jersey, MSBV or an Additional Issuer will, unless specified otherwise in the applicable Final Terms or, in the case of an Additional Issuer, in the accession agreement pursuant to which such Additional Issuer accedes to the Program, be unconditionally and irrevocably guaranteed by Morgan Stanley pursuant to a deed of guarantee dated as of 10 June 2002.
<b>Issue Price</b> .....	Notes may be issued at any price, as specified in the applicable Final Terms, subject to compliance with all applicable legal and regulatory requirements.
<b>Maturities</b> .....	Notes will have maturities as specified in the applicable Final Terms, subject to compliance with all applicable legal and regulatory requirements.  Where Notes have a maturity of less than one year and either (i) the issue proceeds are received by the relevant Issuer in the United Kingdom or (ii) the activity of issuing the Notes is carried on from an establishment maintained by the relevant Issuer in the United Kingdom, such Notes must: (a) have a minimum redemption value of £100,000 (or its equivalent in other currencies) and be issued only to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses; or (b) be issued in other circumstances which do not constitute a contravention of section 19 of the FSMA by the relevant Issuer.
<b>Redemption</b> .....	Notes may be redeemed at par or at such other redemption amount (detailed in a formula or otherwise) or by delivery of securities of an issuer that is not affiliated with Morgan Stanley, as may be specified in the applicable Final Terms.
<b>Early Redemption</b> .....	Early redemption will be permitted for taxation reasons as mentioned in Condition 13 ( <i>Redemption and Purchase</i> ) of "Terms and Conditions of the English Law Notes" but will otherwise be permitted only to the extent specified in the applicable Final Terms.
<b>Interest</b> .....	Notes may be interest-bearing or non-interest-bearing. Interest (if any) may accrue at a fixed rate, which may be zero, or floating rate, or at a rate which varies during the lifetime of the relevant Series.

<b>Denominations .....</b>	Notes will be issued in such denominations as may be specified in the applicable Final Terms, subject to compliance with all applicable legal and regulatory requirements. Notes issued by MSBV will be issued in denominations of at least EUR 1,000 per Note.
<b>Taxation.....</b>	<p>Payments made by Morgan Stanley in respect of Notes issued by Morgan Stanley will be made without withholding or deduction for, or on account of, any present or future Taxes (as defined herein) imposed or levied by or on behalf of the United States or any representative political subdivision thereof or any authority or agency therein or thereof having power to tax, unless the withholding or deduction of those Taxes is required by law. In that event, Morgan Stanley will (subject to customary exceptions) pay those Additional Amounts (as defined herein) as will result in the Noteholders receiving such amounts as they would have received in respect of the Notes had no withholding or deduction been required.</p> <p>Except as otherwise set out in the relevant Final Terms, all payments of principal and interest by Morgan Stanley Jersey or MSBV and the Guarantor in respect of Notes issued by Morgan Stanley Jersey or MSBV shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by (i) in the case of Morgan Stanley Jersey, Jersey (ii) in the case of MSBV, The Netherlands or (iii) in the case of the Guarantor, the United States of America or, in each case, any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. None of Morgan Stanley Jersey, MSBV or the Guarantor shall be required to make any additional payments on account of such withholding or deduction.</p>
<b>Use of Proceeds .....</b>	The net proceeds from the sale of Notes will be used by the relevant Issuer for general corporate purposes, in connection with hedging the relevant Issuer's obligations under the Notes, or both.

<b>Listing</b> .....	<p>Applications have been made to admit the Series A Notes offered under the Program by Morgan Stanley, Morgan Stanley Jersey or MSBV to the Official List of the UK Listing Authority and to trading on the regulated market for gilt edged and fixed income securities of the London Stock Exchange. The applicable Final Terms will specify whether an issue of Series A Notes will be admitted to the Official List of the UK Listing Authority and to trading on the regulated market for gilt edged and fixed income securities of the London Stock Exchange), admitted to listing, trading and/or quotation by any other listing authority, stock exchange and/or quotation system or will be unlisted, as the relevant Issuer and any Distribution Agent may agree. The Series B Notes will not be listed on any exchange.</p> <p>If the proposed European Union Transparency Obligations Directive (the “<b>Directive</b>”) is implemented in a manner which is burdensome for an Issuer or the Guarantor, the Notes may be de-listed. In such a case of de-listing, the relevant Issuer may, but is not obliged to, seek an alternative listing for the Notes on a stock exchange outside the European Union. However, if such an alternative listing is not available or is, in the opinion of the relevant Issuer or the Guarantor (if applicable), burdensome, an alternative listing for the Notes may not be considered. Although no assurance is made as to the liquidity of the Notes as a result of listing by the UK Listing Authority, de-listing the Notes may have a material effect on a Noteholder’s ability to resell the Notes in the secondary market.</p>
<b>Clearing Systems</b> .....	<p>Euroclear, Clearstream, Luxembourg and/or any other clearing system as may be specified in the applicable Final Terms.</p>
<b>Governing Law</b> .....	<p>Unless otherwise specified in the applicable Final Terms, the Notes will be governed by, and construed in accordance with, English law.</p>

<b>Enforcement of Notes in Global Form.....</b>	<p>In the case of English Law Notes issued by Morgan Stanley in global form, individual holders' rights will be governed by a deed of covenant entered into by Morgan Stanley dated 10 June 2002 (the "<b>Morgan Stanley Deed of Covenant</b>"), in the case of Notes issued by Morgan Stanley Jersey in global form, individual holders' rights will be governed by a deed of covenant entered into by Morgan Stanley Jersey dated 10 June 2002 (the "<b>MSJ Deed of Covenant</b>") and in the case of Notes issued by MSBV in global form, individual holders' rights will be governed by a deed of covenant entered into by MSBV dated 4 May 2004 (the "<b>MSBV Deed of Covenant</b>"), copies of which, in each case, will be available for inspection at the specified office of the Fiscal Agent and the Irish Paying Agent.</p> <p>In the case of Notes issued by an Additional Issuer in global form, individual holders' rights will be governed by a deed of covenant to be executed by such Additional Issuer on or around the date on which such Additional Issuer accedes to the Program, a copy of which will be available for inspection at the specified office of the Fiscal Agent and, if appropriate, the Irish Paying Agent.</p>
<b>Selling Restriction.....</b>	<p><b>The Notes may not be offered, sold or delivered at any time, directly or indirectly, within the United States or to or for the account of U.S. Persons (as defined in either Regulation S under the Securities Act or the Code).</b> For a description of certain restrictions on offers, sales and deliveries of the Notes and on the distribution of offering material in the United States and in certain other countries, see "Subscription and Sale" and "No Ownership by U.S. Persons."</p>

## DESCRIPTION OF NEW YORK LAW NOTES

The particular terms of any Notes offered herein will be set forth in the applicable Final Terms (which will, in the case of Notes that will be admitted to the Official List of the UK Listing Authority and admitted to trading on the regulated market for gilt edged and fixed income securities of the London Stock Exchange, when appropriate, be comprised in a supplement to the Base Prospectus). **The terms and conditions set forth in this "Description of New York Law Notes" will apply to each New York Law Note as specified in the applicable Final Terms and in that Note.** The Notes will be offered on a continuing basis.

If any Note is not to be denominated in U.S. dollars, the applicable Final Terms will specify the currency or currencies in which the principal, premium, if any, interest, if any, and supplemental amounts, if any, with respect to that Note are to be paid, along with any other terms relating to the non-U.S. dollar denomination, including for certain issuances historical exchange rates for each relevant foreign currency as against the U.S. dollar and any exchange controls affecting any relevant foreign currency. See " — Interest and Principal Payments."

### General

Notes governed by New York law will be issued under a senior debt Indenture dated as of 15 November 2000 between Morgan Stanley and JPMorgan Chase Bank, N.A. (formerly known as The Chase Manhattan Bank), London Branch, as Trustee (the "**Trustee**") (as supplemented from time to time, the "**Indenture**"). The Notes issued under the Indenture will constitute a single series under that Indenture.

The following summaries of certain provisions of the Indenture and the Notes, and the summaries of additional provisions of the Indenture described under the heading "— Indenture," do not purport to be complete and those summaries are subject to the detailed provisions of the Indenture. The Notes offered by this Base Prospectus and the accompanying Final Terms are sometimes referred to herein as the "**Offered Notes**."

The Indenture does not limit the amount of additional indebtedness that Morgan Stanley or any of its subsidiaries may incur nor does it include a negative pledge provision that would require Morgan Stanley to secure the Notes if it were to secure other senior indebtedness. The Indenture allows Morgan Stanley to "reopen" a previous issue of Notes and issue additional Notes of that issue. The Notes will be direct and general obligations of Morgan Stanley. Most of the assets of Morgan Stanley are owned by its subsidiaries. Therefore, Morgan Stanley's rights and the rights of its creditors, including holders of Notes, to participate in the assets of any subsidiary upon that subsidiary's liquidation or recapitalization will be subject to the prior claims of that subsidiary's creditors, except to the extent that Morgan Stanley may itself be a creditor with recognized claims against the subsidiary. In addition, dividends, loans and advances from certain subsidiaries to Morgan Stanley are restricted by legal requirements, including (in the case of Morgan Stanley & Co. Incorporated ("**MS & Co.**") and Morgan Stanley DW Inc. ("**MSDWI**")) net capital requirements under the Exchange Act and under rules of certain exchanges and other regulatory bodies and (in the case of Discover Bank, a Delaware chartered bank and an indirect wholly owned subsidiary of Morgan Stanley, and other bank subsidiaries) by banking regulations.

The Indenture provides that Notes may be issued from time to time in one or more series and may be denominated and payable in currencies other than U.S. dollars. If not described below under "United States Taxation" or "United Kingdom Taxation," any special United States federal income tax considerations or any United Kingdom withholding tax considerations applicable to any Offered Notes will be described in the applicable Final Terms.

The applicable Final Terms (which will, in the case of Notes that will be admitted to the Official List of the UK Listing Authority and admitted to trading on the regulated market for gilt edged and fixed income securities of the London Stock Exchange, when appropriate, be comprised in a supplement to the Base

Prospectus) will contain, where applicable, the following terms of, and information relating to, any Offered Notes:

- the currency in which the Offered Notes are denominated and/or in which principal, and any premium, interest and/or supplemental amounts, will or may be payable (the "**Specified Currency**"), along with any other terms relating to the non-U.S. dollar denomination, including, if applicable, exchange rates for the Specified Currency as against the U.S. dollar at selected times during previous years, and any exchange controls affecting that Specified Currency;
- the stated maturity date and any terms related to any extension of the maturity date;
- whether the Offered Notes are Notes bearing interest at a fixed rate ("**Fixed Rate Notes**"), Notes bearing interest at a floating rate ("**Floating Rate Notes**"), Notes with original issue discount and/or Amortizing Notes;
- for Fixed Rate Notes, the rate per year at which the Notes will bear interest, if any, or the method of calculating that rate and the dates on which interest will be payable;
- for Floating Rate Notes, the Base Rate, the Index Maturity, the Spread, the Spread Multiplier, the Initial Interest Rate, the Interest Reset Periods, the Interest Payment Dates, the Maximum Interest Rate, the Minimum Interest Rate (each as defined below) and any other terms relating to the particular method of calculating the interest rate for the Notes;
- if the Offered Notes are Amortizing Notes, the amortization schedule;
- whether the Offered Notes may be redeemed, in whole or in part, at the option of Morgan Stanley or repaid at the option of the investor, prior to the stated maturity date, and the terms of any redemption or repayment;
- whether the Offered Notes are Currency-Linked Notes, Credit-Linked Notes and/or Notes linked to commodity prices, securities of entities not affiliated with Morgan Stanley, baskets of those securities or indices;
- the terms on which holders of the Offered Notes may convert or exchange them into or for stock or other securities of entities not affiliated with Morgan Stanley (as well as, in the case of Series B Notes, for securities of an entity that is affiliated with Morgan Stanley), or for the cash value of these securities or for any other property, any specific terms relating to the adjustment of the conversion or exchange feature and the period during which the holders may effect the conversion or exchange;
- whether the Offered Notes will be issued in definitive bearer form or in global bearer form;
- whether the Offered Notes will be admitted to the Official List of the UK Listing Authority and admitted to trading on the regulated market for gilt edged and fixed income securities of the London Stock Exchange or admitted to listing, trading and/or quotation by any other listing authority, stock exchange and/or quotation system;
- the place or places for payment of the principal of and any premium, interest and/or supplemental amounts on the Offered Notes;
- any repayment, redemption, prepayment or sinking fund provisions;
- information as to the methods for determining the amount of principal, interest and/or supplemental amounts payable on any date and/or the currencies, securities or baskets of

securities, commodities or indices to which the amount payable on that date is linked;

- any applicable United States federal income tax consequences other than those set forth herein;
- if applicable, any United Kingdom withholding tax consequences; and
- any other specific terms of the Offered Notes, including any additional events of default or covenants, and any terms required by or advisable under applicable laws or regulations.

Holders may present the Notes for exchange or transfer, in the manner, at the places and subject to the restrictions described under the captions "Subscription and Sale" and "No Ownership By U.S. Persons" and in the Notes and in the applicable Final Terms. These services will be provided without charge except for any tax or other governmental charge payable in connection with these services and subject to any limitations provided in the Indenture.

The Notes will be Fixed Rate Notes or Floating Rate Notes or may pay interest at a rate which varies. The Notes, including Notes bearing no interest or interest at a rate that at the time of issuance is below the prevailing market rate, may be sold at a discount below their stated principal amount.

Except as may be specified for Notes denominated in currencies other than U.S. dollars, the Notes will be issued in denominations of \$1,000, or as otherwise set forth in the applicable Final Terms. Notes denominated in a Specified Currency other than U.S. dollars will be issued in denominations which are the equivalent of such denominations (rounded to an integral multiple of 1,000 units of that Specified Currency, as applicable), or any amount in excess thereof which is an integral multiple of 1,000 units of such Specified Currency, as determined by reference to the noon U.S. dollar buying rate in The City of New York for cable transfers of that Specified Currency published by the Federal Reserve Bank of New York (the "**Market Exchange Rate**") on the Business Day (as defined below) immediately preceding the date of issuance.

As used herein, the following terms have the meanings set forth below:

"**Amortizing Note**" means a Fixed Rate Note (as defined below) that pays a level amount in respect of both interest and principal amortized over the life of the Note.

"**Business Day**" means any day, other than a Saturday or Sunday, (i) that is neither a legal holiday nor a day on which banking institutions are authorized or required by law or regulation to close (a) in The City of New York or in London, or (b) for Notes denominated in a Specified Currency other than U.S. dollars, euro or Australian dollars, in the principal financial center of the country of the Specified Currency, or (c) for Notes denominated in Australian dollars, in Sydney and (ii) for Notes denominated in euro, a day that is also a TARGET Settlement Day.

An "**Interest Payment Date**" for any Note means a date on which, under the terms of that Note, regularly scheduled interest is payable.

"**Euro LIBOR Notes**" means LIBOR Notes for which the Index Currency is euros.

"**London banking day**" means any day on which dealings in deposits in the relevant Index Currency (as defined under " — Base Rates — LIBOR Notes" below) are transacted in the London interbank market.

"**Original Issue Discount Note**" means any Note that provides for an amount less than the principal amount thereof to be due and payable upon a declaration of acceleration of the maturity thereof pursuant to the relevant Indenture.

"**TARGET Settlement Day**" means any day on which the Trans-European Automated Real-time Gross Settlement Express Transfer System ("**TARGET**") is open.

## **Form and Title**

Unless otherwise specified in the applicable Final Terms, the Notes will be issued in global bearer form without coupons attached. For a more complete description of the form of Notes and of the consequences of holding an interest in a global bearer note, see "Forms of Notes" above.

The Notes and any coupons issued with the Notes will be transferable by delivery. The investor may present them for payment and exchange in the manner set forth above.

## **Interest and Principal Payments**

*Global Bearer Notes.* The Principal Paying Agent or any other paying agent will pay interest on a temporary global bearer note to Euroclear and Clearstream, Luxembourg or, as applicable, any other relevant clearing system on that portion of the temporary global bearer note held for its account. See "Forms of Notes" above. The Principal Paying Agent or any other paying agent will pay interest to Euroclear and Clearstream, Luxembourg or, as applicable, any other relevant clearing system only on that portion of the principal amount of the relevant temporary global bearer note for which it receives an Ownership Certificate, as defined in "Forms of Notes" above, signed by Euroclear or Clearstream, Luxembourg or, as applicable, any other relevant clearing system. The Ownership Certificate must be dated no earlier than such Interest Payment Date. The Ownership Certificate will be based on Ownership Certificates provided to Euroclear or Clearstream, Luxembourg or, as applicable, any other relevant clearing system by its participants. Euroclear and Clearstream, Luxembourg or, as applicable, any other relevant clearing system will credit interest received to the accounts of the participants for the beneficial owners of those accounts only if the participants have furnished Ownership Certificates.

The person entitled to receive the principal of, or interest and/or supplemental amounts on, a temporary global bearer note must furnish an Ownership Certificate through the broker or other direct or indirect participant in the clearing systems through which it holds its interest in order to receive any principal or interest and/or supplemental amounts.

On the Exchange Date and upon receipt of the required Ownership Certificates, the Principal Paying Agent or any other paying agent will exchange the temporary global bearer note for the related permanent global bearer note. The Principal Paying Agent or any other paying agent will pay the principal, premium, if any, interest and/or supplemental amounts, if any, on the permanent global bearer note to Euroclear and Clearstream, Luxembourg or, as applicable, any other relevant clearing system with respect to that portion of the permanent global bearer note held for its account. At maturity, redemption or repayment or on an Interest Payment Date, Euroclear and Clearstream, Luxembourg or, as applicable, any other relevant clearing system will credit the principal, premium, if any, interest and/or supplemental amounts, if any, received to the respective accounts of the beneficial owners of the permanent global bearer note. Payment of principal, premium, if any, interest and/or supplemental amounts, if any, made on any permanent global bearer note will be made to Euroclear and Clearstream, Luxembourg or, as applicable, any other relevant clearing system in immediately available funds, subject to any applicable laws and regulations.

*Definitive Bearer Notes.* The Principal Paying Agent or any other paying agent will pay principal, premium, if any, interest and/or supplemental amounts, if any, on a definitive bearer note at maturity, upon redemption or repayment or on any Interest Payment Date only if the Notes and/or any coupons relating to that Interest Payment Date are presented and surrendered. The definitive bearer notes must be presented and surrendered at the offices of a paying agent outside the United States. The holder has the option to receive payment (1) by check or (2) by wire transfer of immediately available funds to an account maintained by the payee with a bank located outside the United States. To elect the second option, the Principal Paying Agent or any other paying agent must receive appropriate wire transfer



instructions not less than 15 calendar days prior to an applicable payment date. Payment will be made in immediately available funds, subject to any applicable laws and regulations.

**Payment on any Note will not be made:**

- at any office or agency of Morgan Stanley in the United States;
- by check mailed to any address in the United States; or
- by wire transfer to an account maintained with a bank located in the United States.

Despite these general prohibitions, payments of principal, premium, if any, interest and/or supplemental amounts, if any, on Notes payable in U.S. dollars will be made at the office of Morgan Stanley's paying agent in the Borough of Manhattan, The City of New York, *if and only if*:

- the payment of the full amount in U.S. dollars at all offices or agencies outside the United States is illegal or effectively precluded by exchange controls or other similar restrictions; and
- under applicable United States law, the paying agent in the Borough of Manhattan, The City of New York, would be able to make the payment without adverse United States federal tax consequences or other adverse consequences to Morgan Stanley.

*Unavailability of Currency.* The relevant Specified Currency may not be available to Morgan Stanley for making payments of principal of, and premium, interest and/or supplemental amounts, if any, on any Note. This could occur due to the imposition of exchange controls or other circumstances beyond the control of Morgan Stanley or if the Specified Currency is no longer used by the government of the country issuing that currency or by public institutions within the international banking community for the settlement of transactions. If the Specified Currency is unavailable, Morgan Stanley may satisfy its obligations to Noteholders by making those payments on the date of payment in U.S. dollars on the basis of the Market Exchange Rate on the date of the payment or of the most recent practicable date, or if that rate of exchange is not then available or is not published for that particular payment currency, the Market Exchange Rate will be based on the highest bid quotation in The City of New York received by the Exchange Rate Agent at approximately 11:00 a.m., New York City time, on the second Business Day preceding the applicable payment date from three recognized foreign exchange dealers for the purchase by the quoting dealer:

- of the Specified Currency for U.S. dollars for settlement on the payment date;
- in the aggregate amount of the Specified Currency payable to those holders or beneficial owners of Notes; and
- at which the applicable dealer commits to execute a contract.

If those bid quotations are not available, the Exchange Rate Agent will determine the Market Exchange Rate at its sole discretion. All determinations by the Exchange Rate Agent will, in the absence of manifest error, be conclusive for all purposes and binding on Morgan Stanley and the Noteholders. The Exchange Rate Agent will be Morgan Stanley & Co. International Limited, an affiliate of Morgan Stanley, unless otherwise noted in the applicable Final Terms. If the Exchange Rate Agent is not an affiliate of Morgan Stanley, it may be one of the dealers providing quotations.

Any payment made in U.S. dollars on the basis of the Market Exchange Rate where the required payment is in an unavailable Specified Currency will not constitute an Event of Default under the Indenture.

These provisions do not apply if a Specified Currency is unavailable because it has been replaced by the euro. If the euro has been substituted for a Specified Currency, we may at our option (or will, if required

by applicable law) without the consent of the holders of the affected Notes, pay the principal of, premium, if any, or interest, if any, on any Note denominated in the Specified Currency in euro instead of the Specified Currency, in conformity with legally applicable measures taken pursuant to, or by virtue of, the Treaty. Any payment made in U.S. dollars or in euro as described above where the required payment is in an unavailable Specified Currency will not constitute an Event of Default under the Indenture.

*Unclaimed Payments.* If Morgan Stanley has made, and the Trustee or the Principal Paying Agent or any other paying agent has held, any payment of the principal of, or any premium, interest and/or supplemental amounts on, any Notes that remains unclaimed at the end of two years after that payment has become due and payable (whether at maturity or upon call for redemption or otherwise):

- the Trustee or such paying agent will notify the holders of such Notes that moneys will be repaid to Morgan Stanley, and any person claiming such moneys will thereafter look only to Morgan Stanley for payment thereof; and
- those moneys will be so repaid to Morgan Stanley.

Upon that repayment all liability of the Trustee or such paying agent with respect to those moneys will thereupon cease, without, however, limiting in any way any obligation that Morgan Stanley may have to pay the principal of, or any premium, interest and/or supplemental amounts on, the Notes as the same will become due.

*Original Issue Discount Notes.* Certain Notes may be Original Issue Discount Notes. Unless otherwise specified in the applicable Final Terms, if the principal of any Note that is considered to be issued with original issue discount is declared to be due and payable immediately as described under "—Events of Default" below or is redeemed as described under "—Tax Redemption" below, the amount of principal due and payable on that Note will be limited to:

- the aggregate principal amount of the Note *multiplied by*
- the sum of its issue price, expressed as a percentage of the aggregate principal amount, *plus*
- the original issue discount amortized from the date of issue to the date of declaration, expressed as a percentage of the aggregate principal amount.

The amortization will be calculated using the "interest method," computed in accordance with generally accepted accounting principles in effect on the date of declaration. See the applicable Final Terms for any special considerations applicable to these Notes.

### **Exchanges; Paying Agent for the Notes**

Definitive bearer notes and any coupons are transferable by delivery. The investor may exchange definitive bearer notes for other notes in other authorized denominations and in an equal aggregate principal amount. The exchange will take place at the offices of the Principal Paying Agent in London or at the office of any agent that Morgan Stanley designates for that purpose. The terms of, and procedures established under, the Indenture govern any exchange of the definitive bearer notes.

Morgan Stanley has designated JPMorgan Chase Bank, N.A., London Branch, as its Principal Paying Agent for the Notes and J.P. Morgan Bank (Ireland) plc (formerly known as Chase Manhattan Bank (Ireland) plc) as an additional paying agent for the Notes. Morgan Stanley may at any time appoint additional paying agents for the Notes outside the United States. Any initial designation by Morgan Stanley of an agent may be rescinded at any time, except that, so long as any Notes remain outstanding, Morgan Stanley will maintain a paying agent having a specified office in London, so long as any Notes are admitted to the Official List of the UK Listing Authority and admitted to trading on the regulated

market for fixed income securities of the London Stock Exchange and the UK Listing Authority requires it. If any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive is introduced, Morgan Stanley will endeavour to maintain a paying agent in a member state of the European Union that will not be obligated to withhold or deduct tax pursuant to any such Directive or law.

**Morgan Stanley will not be required to:**

- exchange notes to be redeemed for a period of fifteen calendar days preceding the publication of the relevant notice of redemption, or
- exchange any definitive bearer note selected for redemption or surrendered for optional repayment.

**Fixed Rate Notes**

Each Fixed Rate Note will bear interest from the date of issuance at the annual rate stated on its face until the principal is paid or made available for payment.

*How Interest Is Calculated.* Interest on Fixed Rate Notes will be computed on the basis of a 360-day year of twelve 30-day months.

*How Interest Accrues.* Interest on Fixed Rate Notes will accrue from and including the most recent Interest Payment Date to which interest has been paid or duly provided for, or, if no interest has been paid or duly provided for, from and including the issue date or any other date specified in a Final Terms on which interest begins to accrue. Interest will accrue to but excluding the next Interest Payment Date or, if earlier, excluding the date on which the principal has been paid or duly made available for payment (except as described below under " — If a Payment Date is Not a Business Day").

*When Interest Is Paid.* Payments of interest on Fixed Rate Notes will be made on the Interest Payment Dates specified in the applicable Final Terms. However, if the first Interest Payment Date is less than 15 days after the date of issuance, interest will not be paid on the first Interest Payment Date, but will be paid on the second Interest Payment Date.

*Amount of Interest Payable.* Interest payments for Fixed Rate Notes will include accrued interest from and including the date of issue or from and including the last date in respect of which interest has been paid, as the case may be, to but excluding the relevant interest payment date or date of maturity or earlier redemption or repayment, as the case may be.

*If a Payment Date Is Not a Business Day.* If any scheduled Interest Payment Date is not a Business Day, Morgan Stanley will pay interest on the next Business Day, but interest on that payment will not accrue during the period from and after the Interest Payment Date. If the scheduled maturity date or date of redemption or repayment is not a Business Day, Morgan Stanley may pay principal, premium, interest and/or supplemental amounts, if any, on the next succeeding Business Day, but interest on that payment will not accrue during the period from and after the maturity date or date of redemption or repayment.

*Amortizing Notes.* A Fixed Rate Note may pay a level amount in respect of both interest and principal amortized over the life of the Note. Payments of principal and interest on Amortizing Notes will be made on the Interest Payment Dates specified in the applicable Final Terms, and at maturity or upon any earlier date of redemption or repayment. Payments on Amortizing Notes will be applied first to interest due and payable and then to the reduction of the unpaid principal amount. Morgan Stanley will provide to the original purchaser, and will furnish to subsequent holders upon request to Morgan Stanley, a table setting forth repayment information for each Amortizing Note.

## Floating Rate Notes

Each Floating Rate Note will mature on the date specified in the applicable Final Terms.

Each Floating Rate Note will bear interest at a floating rate determined by reference to an interest rate or interest rate formula (the "**Base Rate**"). The Base Rate may be one or more of the following:

- the CD Rate
- the Commercial Paper Rate
- EURIBOR
- the Federal Funds Rate
- the Federal Funds (Open) Rate
- LIBOR
- the Prime Rate
- the Treasury Rate
- the CMT Rate, or
- any other rate or interest rate formula specified in the applicable Final Terms and in the Floating Rate Note.

*Formula for Interest Rates.* The interest rate on each Floating Rate Note will be calculated by reference to:

- the specified Base Rate based on the Index Maturity
- *plus* or *minus* the Spread, if any, and/or
- *multiplied by* the Spread Multiplier, if any.

The interest rate on each Floating Rate Note may, during all or any part of the period that it is outstanding, be set at zero.

"**Index Maturity**" means, for any Floating Rate Note, the period of maturity of the instrument or obligation from which the Base Rate is calculated and will be specified in the applicable Final Terms. The "**Spread**" is the number of basis points (one one-hundredth of a percentage point) specified in the applicable Final Terms to be added to or subtracted from the Base Rate for a Floating Rate Note. The "**Spread Multiplier**" is the percentage specified in the applicable Final Terms to be applied to the Base Rate for a Floating Rate Note. The interest rate on any inverse Floating Rate Note will also be calculated by reference to a fixed rate.

*Limitations on Interest Rate.* A Floating Rate Note may also have either or both of the following limitations on the interest rate:

- a maximum limitation, or ceiling, on the rate of interest which may accrue during any interest period ("**Maximum Interest Rate**"); and/or
- a minimum limitation, or floor, on the rate of interest that may accrue during any interest period ("**Minimum Interest Rate**").

Any applicable Maximum Interest Rate or Minimum Interest Rate will be set forth in the applicable Final Terms.

In addition, the interest rate on a Floating Rate Note may not be higher than the maximum rate permitted by New York law, as that rate may be modified by United States federal law of general application. Under current New York law, the maximum rate of interest, subject to some exceptions, for any loan in an amount less than U.S.\$250,000 is 16% and for any loan in the amount of U.S.\$250,000 or more but less than U.S.\$2,500,000 is 25% per annum on a simple interest basis. These limits do not apply to loans of U.S.\$2,500,000 or more.

*How Floating Interest Rates Are Reset.* The interest rate in effect from the date of issue to the first Interest Reset Date for a Floating Rate Note will be the initial interest rate specified in the applicable Final Terms. This rate is the "**Initial Interest Rate.**" The interest rate on each Floating Rate Note may be reset daily, weekly, monthly, quarterly, semiannually or annually. This period is the "**Interest Reset Period**" and the first day of each Interest Reset Period is the "**Interest Reset Date.**" The "**Interest Determination Date**" pertaining to any Interest Reset Date is the day the Calculation Agent (which will be specified for any issue of Floating Rate Notes in the applicable Final Terms) will refer to when determining the new interest rate at which a Floating Rate Note will reset, and is applicable as follows:

- for Federal Funds Rate Notes, Federal Funds (Open) Rate Notes, and Prime Rate Notes, the Interest Determination Date will be on the Business Day prior to the Interest Rate Reset Date;
- for CD Rate Notes, Commercial Paper Rate Notes and CMT Rate Notes, the Interest Determination Date will be the second Business Day prior to the Interest Reset Date;
- for EURIBOR Notes or Euro LIBOR Notes, the Interest Determination Date will be the second TARGET Settlement Day (as defined under "—General") prior to the Interest Reset Date;
- for LIBOR Notes (other than Euro LIBOR Notes), the Interest Determination Date will be the second London Banking Day prior to the Interest Reset Date, except that the Interest Determination Date pertaining to an Interest Reset Date for a LIBOR Note for which the Index Currency is pounds sterling will be the Interest Reset Date;
- for Treasury Rate Notes, the Interest Determination Date will be the day of the week in which the Interest Reset Date falls on which Treasury bills would normally be auctioned; and
- for Notes with two or more Base Rates, the Interest Determination Date will be the latest Business Day that is at least two Business Days before the Interest Reset Date for the applicable Note on which each Base Rate is determinable.

Treasury bills are normally sold at auction on Monday of each week, unless that day is a legal holiday, in which case the auction is normally held on the following Tuesday, except that the auction may be held on the preceding Friday; *provided, however*, that if an auction is held on the Friday of the week preceding the Interest Reset Date, the Interest Determination Date will be that preceding Friday. If an auction falls on a day that is an Interest Reset Date, that Interest Reset Date will be the next following Business Day.

The Interest Reset Dates will be specified in the applicable Final Terms. If an Interest Reset Date for any Floating Rate Note falls on a day that is not a Business Day, it will be postponed to the following Business Day, except that, in the case of a EURIBOR Note or a LIBOR Note, if that Business Day is in the next calendar month, the Interest Reset Date will be the immediately preceding Business Day.

The interest rate in effect for the ten calendar days immediately prior to maturity, redemption or repayment will be the one in effect on the tenth calendar day preceding the maturity, redemption or repayment date.

In the detailed descriptions of the various Base Rates which follow, the "**Calculation Date**" pertaining to an Interest Determination Date means the earlier of (i) the tenth calendar day after the Interest Determination Date, or, if that day is not a Business Day, the next succeeding Business Day, and (ii) the Business Day immediately preceding the applicable Interest Payment Date or maturity date or, for any principal amount to be redeemed or repaid, any redemption or repayment date.

*How Interest Is Calculated.* Interest on Floating Rate Notes will accrue from and include the most recent Interest Payment Date to which interest has been paid or duly provided for, or, if no interest has been paid or duly provided for, from and including the issue date or any other date specified in a Final Terms on which interest begins to accrue. Interest will accrue to but exclude the next Interest Payment Date, or, if earlier, the date on which the principal has been paid or duly made available for payment (except as described under " — If a Payment Date Is Not a Business Day" below).

The applicable Final Terms will specify a calculation agent for any issue of Floating Rate Notes (the "**Calculation Agent**"). Upon the request of the holder of any Floating Rate Note, the Calculation Agent will provide the interest rate then in effect and, if determined, the interest rate that will become effective on the next Interest Reset Date for that Floating Rate Note. As long as any Floating Rate Notes have been admitted to the Official List of the UK Listing Authority and admitted to trading on the regulated market for fixed income securities of the London Stock Exchange) and the rules of the UK Listing Authority and/or the London Stock Exchange require it, the Calculation Agent will, no later than the first day of the applicable Interest Reset Period, notify the UK Listing Authority and/or the London Stock Exchange as to the interest rate in effect for such Interest Reset Period and will also publish notice of the relevant interest rate and the applicable Interest Reset Period in the manner described below under " — Notices" or make such information available to holders at the offices of the Principal Paying Agent.

For a Floating Rate Note, accrued interest will be calculated by multiplying the principal amount of the Floating Rate Note by an accrued interest factor. This accrued interest factor will be computed by adding the interest factors calculated for each day in the period for which interest is being paid. The interest factor for each day is computed by *dividing* the interest rate applicable to that day:

- by 360, in the case of CD Rate Notes, Commercial Paper Rate Notes, EURIBOR Notes, Federal Funds Rate Notes, Federal Funds (Open) Rate Notes, LIBOR Notes (except for LIBOR Notes denominated in pounds sterling) and Prime Rate Notes;
- by 365, in the case of LIBOR Notes denominated in pounds sterling; or
- by the actual number of days in the year, in the case of Treasury Rate Notes and CMT Rate Notes.

For these calculations, the interest rate in effect on any Interest Reset Date will be the applicable rate as reset on that date. The interest rate applicable to any other day is the interest rate from the immediately preceding Interest Reset Date (or, if none, the Initial Interest Rate).

All percentages used in or resulting from any calculation of the rate of interest on a Floating Rate Note will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point, with 0.000005% rounded up to 0.00001%, and all U.S. dollar amounts used in or resulting from these calculations on Floating Rate Notes will be rounded to the nearest cent, with one-half cent rounded upward. All Japanese Yen amounts used in or resulting from such calculations will be rounded downward to the next lower whole Japanese Yen amount. All amounts denominated in any other currency used in or resulting from such calculations will be rounded to the nearest two decimal places in such currency, with 0.005 rounded up to 0.01.

*When Interest Is Paid.* Morgan Stanley will pay interest on Floating Rate Notes on the Interest Payment Dates specified in the applicable Final Terms. However, if the first Interest Payment Date is less than 15

days after the date of issuance, interest will not be paid on the first Interest Payment Date, but will be paid on the second Interest Payment Date.

*If a Payment Date Is Not a Business Day.* If any scheduled Interest Payment Date, other than the maturity date or any earlier redemption or repayment date, for any Floating Rate Note falls on a day that is not a Business Day, it will be postponed to the following Business Day, except that, in the case of a EURIBOR Note or a LIBOR Note, if that Business Day would fall in the next calendar month, the Interest Payment Date will be the immediately preceding Business Day. If the scheduled maturity date or any earlier redemption or repayment date of a Floating Rate Note falls on a day that is not a Business Day, the payment of principal, premium, if any, and interest and/or supplemental amounts, if any, will be made on the next succeeding Business Day, but interest on that payment will not accrue during the period from and after the maturity, redemption or repayment date.

## **Base Rates**

### *CD Rate Notes*

CD Rate Notes will bear interest at the interest rates specified in the CD Rate Notes and in the applicable Final Terms. Those interest rates will be based on the CD Rate and any spread and/or spread multiplier and will be subject to the Minimum Interest Rate and the Maximum Interest Rate, if any.

The "**CD Rate**" means, for any Interest Determination Date, the rate on that date for negotiable U.S. dollar certificates of deposit having the Index Maturity specified in the applicable Final Terms as published by the Board of Governors of the Federal Reserve System in "Statistical Release H.15(519), Selected Interest Rates," or any successor publication of the Board of Governors of the Federal Reserve System ("**H.15(519)**") under the heading "CDs (Secondary Market)."

The following procedures will be followed if the CD Rate cannot be determined as described above:

- If the above rate is not published in H.15(519) by 3:00 p.m., New York City time, on the Calculation Date, the CD Rate will be the rate on that Interest Determination Date set forth in the daily update of H.15(519), available through the world wide website of the Board of Governors of the Federal Reserve System at <http://www.federalreserve.gov/releases/h15/update> or any successor site or publication ("**H.15 Daily Update**") for the Interest Determination Date for certificates of deposit having the Index Maturity specified in the applicable Final Terms under the caption "CDs (Secondary Market)."
- If the above rate is not yet published in either H.15(519) or the H.15 Daily Update by 3:00 p.m., New York City time, on the Calculation Date, the Calculation Agent will determine the CD Rate to be the arithmetic mean of the secondary market offered rates as of 10:00 a.m., New York City time, on that Interest Determination Date of three leading nonbank dealers in negotiable U.S. dollar certificates of deposit in The City of New York, which may include the Distribution Agents or their affiliates, selected by the Calculation Agent, after consultation with Morgan Stanley, for negotiable U.S. dollar certificates of deposit of major U.S. money center banks of the highest credit standing in the market for negotiable certificates of deposit with a remaining maturity closest to the Index Maturity specified in the applicable Final Terms in an amount that is representative for a single transaction in that market at that time.
- If the dealers selected by the Calculation Agent are not quoting as set forth above, the CD Rate for that Interest Determination Date will remain the CD Rate for the immediately preceding Interest Reset Period, or, if there was no Interest Reset Period, the rate of interest payable will be the Initial Interest Rate.

### *Commercial Paper Rate Notes*

Commercial Paper Rate Notes will bear interest at the interest rates specified in the Commercial Paper Rate Notes and in the applicable Final Terms. Those interest rates will be based on the Commercial Paper Rate and any Spread and/or Spread Multiplier and will be subject to the Minimum Interest Rate and the Maximum Interest Rate, if any.

The "**Commercial Paper Rate**" means, for any Interest Determination Date, the Money Market Yield, calculated as described below, computed using the rate on that date for U.S. dollar commercial paper having the Index Maturity specified in the applicable Final Terms, as that rate is published in H.15(519), under the heading "Commercial Paper — Nonfinancial."

The following procedures will be followed if the Commercial Paper Rate cannot be determined as described above:

- If the above rate is not published by 3:00 p.m., New York City time, on the Calculation Date, then the Commercial Paper Rate will be the Money Market Yield computed using the rate on that Interest Determination Date for commercial paper of the Index Maturity specified in the applicable Final Terms as published in the H.15 Daily Update, or other recognised electronic source used for the purpose of displaying the applicable rate, under the heading "Commercial Paper — Nonfinancial."
- If by 3:00 p.m., New York City time, on that Calculation Date the rate is not yet published in either H.15(519) or the H.15 Daily Update, or other recognised electronic source used for the purpose of displaying the applicable rate, then the Calculation Agent will determine the Commercial Paper Rate to be the Money Market Yield computed using the arithmetic mean of the offered rates as of 11:00 a.m., New York City time, on that Interest Determination Date of three leading dealers of U.S. dollar commercial paper in The City of New York, which may include the Distribution Agents or their affiliates, selected by the Calculation Agent, after consultation with Morgan Stanley, for commercial paper of the Index Maturity specified in the applicable Final Terms, placed for an industrial issuer whose bond rating is "Aa," or the equivalent, from a nationally recognized statistical rating agency.
- If the dealers selected by the Calculation Agent are not quoting as set forth above, the Commercial Paper Rate for that Interest Determination Date will remain the Commercial Paper Rate for the immediately preceding Interest Reset Period, or, if there was no Interest Reset Period, the rate of interest payable will be the Initial Interest Rate.

The "**Money Market Yield**" will be a yield calculated in accordance with the following formula:

$$\text{Money Market Yield} = \frac{D \times 360}{360 - (D \times M)} \times 100$$

where "D" refers to the applicable per year rate for commercial paper quoted on a bank discount basis and expressed as a decimal and "M" refers to the actual number of days in the interest period for which interest is being calculated.

### *EURIBOR Notes*

EURIBOR Notes will bear interest at the interest rates specified in the EURIBOR Notes and in the applicable Final Terms. That interest rate will be based on EURIBOR and any Spread and/or Spread Multiplier and will be subject to the Minimum Interest Rate and the Maximum Interest Rate, if any.



"**EURIBOR**" means, for any Interest Determination Date, the rate for deposits in euros as sponsored, calculated and published jointly by the European Banking Federation and ACI - The Financial Market Association, or any company established by the joint sponsors for purposes of compiling and publishing those rates, for the Index Maturity specified in the applicable Final Terms as that rate appears on the display on Moneyline Telerate, or any successor service, on page 248 or any other page as may replace page 248 on that service ("**Telerate Page 248**") as of 11:00 a.m., Brussels time.

The following procedures will be followed if the rate cannot be determined as described above:

- If the above rate does not appear, the Calculation Agent will request the principal Euro-zone office of each of four major banks in the Euro-zone interbank market, as selected by the Calculation Agent, after consultation with Morgan Stanley, to provide the Calculation Agent with its offered rate for deposits in euros, at approximately 11:00 a.m., Brussels time, on the Interest Determination Date, to prime banks in the Euro-zone interbank market for the Index Maturity specified in the applicable Final Terms commencing on the applicable Interest Reset Date, and in a principal amount not less than the equivalent of U.S.\$1 million in euro that is representative of a single transaction in euro, in that market at that time. If at least two quotations are provided, EURIBOR will be the arithmetic mean of those quotations.
- If fewer than two quotations are provided, EURIBOR will be the arithmetic mean of the rates quoted by four major banks in the Euro-zone interbank market, as selected by the Calculation Agent, after consultation with Morgan Stanley, at approximately 11:00 a.m., Brussels time, on the applicable Interest Reset Date for loans in euro to leading European banks for a period of time equivalent to the Index Maturity specified in the applicable Final Terms commencing on that Interest Reset Date in a principal amount not less than the equivalent of U.S.\$1 million in euro.
- If the banks selected by the Calculation Agent are not quoting as set forth above, EURIBOR for that Interest Determination Date will remain EURIBOR for the immediately preceding Interest Reset Period, or, if there was no Interest Reset Period, the rate of interest payable will be the Initial Interest Rate.

"**Euro-zone**" means the region comprising member states of the European Union that have adopted the single currency in accordance with the Treaty.

#### *Federal Funds Rate Notes*

Federal Funds Rate Notes will bear interest at the interest rates specified in the Federal Funds Rate Notes and in the applicable Final Terms. Those interest rates will be based on the Federal Funds Rate and any Spread and/or Spread Multiplier and will be subject to the Minimum Interest Rate and the Maximum Interest Rate, if any.

The "**Federal Funds Rate**" means, for any Interest Determination Date, the rate on that date for U.S. dollar Federal Funds as published in H.15(519) under the heading "Federal Funds (Effective)" as displayed on Moneyline Telerate, or any successor service, on page 120 or any other page as may replace the applicable page on that service, which is commonly referred to as "Telerate Page 120."

The following procedures will be followed if the Federal Funds Rate cannot be determined as described above:

- If the above rate is not published by 3:00 p.m., New York City time, on the Calculation Date, the Federal Funds Rate will be the rate on that Interest Determination Date as published in the H.15 Daily Update, or other recognised electronic source used for the purpose of displaying the applicable rate, under the heading "Federal Funds (Effective)."

- If the above rate is not yet published in either H.15(519) or the H.15 Daily Update, or other recognised electronic source used for the purpose of displaying the applicable rate, by 3:00 p.m., New York City time, on the Calculation Date, the Calculation Agent will determine the Federal Funds Rate to be the arithmetic mean of the rates for the last transaction in overnight U.S. dollar federal funds as of 9:00 a.m., New York City time, on that Interest Determination Date by each of three leading brokers of U.S. dollar Federal Funds transactions in The City of New York, which may include the Distribution Agents or their affiliates, selected by the Calculation Agent, after consultation with Morgan Stanley.
- If the brokers selected by the Calculation Agent are not quoting as set forth above, the Federal Funds Rate for that Interest Determination Date will remain the Federal Funds Rate for the immediately preceding Interest Reset Period, or, if there was no Interest Reset Period, the rate of interest payable will be the Initial Interest Rate.

*Federal Funds (Open) Rate Notes.*

Federal Funds (Open) Rate Notes will bear interest at the interest rates specified in the Federal Funds (Open) Rate Notes and in the Final Terms. Those interest rates will be based on the Federal Funds (Open) Rate and any Spread and/or Spread Multiplier and will be subject to the Minimum Interest Rate and the Maximum Interest Rate, if any.

The “Federal Funds (Open) Rate” means, for any Interest Determination Date, the rate on that date for U.S. dollar Federal Funds as published in H.15(519) under the heading “Federal Funds (Open)” as displayed by Moneyline Telerate, or any successor service, on page 5 or any other page as may replace the applicable page on that service, which is commonly referred to as Telerate Page 5.

The following procedures will be followed if the Federal Funds (Open) Rate cannot be determined as described above:

- If the above rate is not published by 3.00 p.m., New York City time, on the Calculation Date, the Federal Funds (Open) Rate will be the rate on that Interest Determination Date as published in the H.15 Daily Update, or other recognised electronic source used for the purpose of displaying the applicable rate, under the heading “Federal Funds (Open)”.
- If the above rate is not yet published in either H.15(519) or the H.15 Daily Update, or other recognised electronic source used for the purpose of displaying the applicable rate, by 3.00 p.m., New York City time, on the Calculation Date, the Calculation Agent will determine the Federal Funds (Open) Rate to be the arithmetic mean of the rates for the last transaction in overnight U.S. dollar Federal Funds (based on the Federal Funds (Open) Rate prior to 9.00 a.m., New York City time, on that Interest Determination Date, by each of three leading brokers of U.S. dollar Federal Funds transactions in The City of New York, which may include the agent and its affiliates, selected by the Calculation Agent, after consultation with Morgan Stanley.
- If the brokers selected by the Calculation Agent are not quoting as set forth above, the Federal Funds (Open) Rate for that Interest Determination Date will remain the Federal Funds (Open) Rate for the immediately preceding Interest Reset Period, or, if there was no Interest Reset Period, the rate of interest payable will be the Initial Interest Rate.

*LIBOR Notes*

LIBOR Notes will bear interest at the interest rates specified in the LIBOR Notes and in the applicable Final Terms. That interest rate will be based on London Interbank Offered Rate (“LIBOR”) and any Spread and/or Spread Multiplier and will be subject to the Minimum Interest Rate and the Maximum Interest Rate, if any.

The Calculation Agent will determine "LIBOR" for each Interest Determination Date as follows:

- As of the Interest Determination Date, LIBOR will be either:
  - if "LIBOR Reuters" is specified in the applicable Final Terms, the arithmetic mean of the offered rates for deposits in the Index Currency having the Index Maturity designated in the applicable Final Terms, commencing on the second London banking day immediately following that Interest Determination Date, that appear on the Designated LIBOR Page as of 11:00 a.m., London time, on that Interest Determination Date, if at least two offered rates appear on the Designated LIBOR Page; provided that if the specified Designated LIBOR Page, as defined below, by its terms provides only for a single rate, that single rate will be used; or
  - if "LIBOR Telerate" is specified in the applicable Final Terms, the rate for deposits in the Index Currency having the Index Maturity designated in the applicable Final Terms, commencing on the second London banking day immediately following that Interest Determination Date or, if pounds sterling is the Index Currency, commencing on that Interest Determination Date, that appears on the Designated LIBOR Page at approximately 11:00 a.m., London time, on that Interest Determination Date.
- If (i) fewer than two offered rates appear and "LIBOR Reuters" is specified in the applicable Final Terms, or (ii) no rate appears and the applicable Final Terms specifies either (a) "LIBOR Telerate" or (b) "LIBOR Reuters" and the Designated LIBOR page by its terms provides only for a single rate then the Calculation Agent will request the principal London offices of each of four major reference banks in the London interbank market, as selected by the Calculation Agent, after consultation with Morgan Stanley, to provide the Calculation Agent with its offered quotation for deposits in the Index Currency for the period of the Index Maturity specified in the applicable Final Terms commencing on the second London banking day immediately following the Interest Determination Date or, if pounds sterling is the Index Currency, commencing on that Interest Determination Date, to prime banks in the London interbank market at approximately 11:00 a.m., London time, on that Interest Determination Date and in a principal amount that is representative of a single transaction in that Index Currency in that market at that time.
- If at least two quotations are provided, LIBOR determined on that Interest Determination Date will be the arithmetic mean of those quotations. If fewer than two quotations are provided, LIBOR will be determined for the applicable Interest Reset Date as the arithmetic mean of the rates quoted at approximately 11:00 a.m., London time, or some other time specified in the applicable Final Terms, in the applicable principal financial center for the country of the Index Currency on that Interest Reset Date, by three major banks in that principal financial center selected by the Calculation Agent, after consultation with Morgan Stanley, for loans in the Index Currency to leading European banks, having the Index Maturity specified in the applicable Final Terms and in a principal amount that is representative of a single transaction in that Index Currency in that market at that time.
- If the banks so selected by the Calculation Agent are not quoting as set forth above, LIBOR for that Interest Determination Date will remain LIBOR for the immediately preceding Interest Reset Period, or, if there was no Interest Reset Period, the rate of interest payable will be the Initial Interest Rate.

The "**Index Currency**" means the currency specified in the applicable Final Terms as the currency for which LIBOR will be calculated, or, if the euro is substituted for that currency, the Index Currency will be the euro. If that currency is not specified in the applicable Final Terms, the Index Currency will be U.S. dollars.

**"Designated LIBOR Page"** means either (i) if "LIBOR Reuters" is designated in the applicable Final Terms, the display on the Reuters Money 3000 Service for the purpose of displaying the London interbank rates of major banks for the applicable Index Currency or its designated successor, or (ii) if "LIBOR Telerate" is designated in the applicable Final Terms, the display on Telerate, or any successor service, on the page specified in the applicable Final Terms, or any other page as may replace that page on that service, for the purpose of displaying the London interbank rates of major banks for the applicable Index Currency.

If neither LIBOR Reuters nor LIBOR Telerate is specified in the applicable Final Terms, LIBOR for the applicable Index Currency will be determined as if LIBOR Telerate were specified, and, if the U.S. dollar is the Index Currency, as if Page 3750, had been specified.

#### *Prime Rate Notes*

Prime Rate Notes will bear interest at the interest rates specified in the Prime Rate Notes and in the applicable Final Terms. That interest rate will be based on the Prime Rate and any Spread and/or Spread Multiplier, and will be subject to the Minimum Interest Rate and the Maximum Interest Rate, if any.

The **"Prime Rate"** means, for any Interest Determination Date, the rate on that date as published in H.15(519) under the heading "Bank Prime Loan."

The following procedures will be followed if the Prime Rate cannot be determined as described above:

- If the above rate is not published prior to 3:00 p.m., New York City time, on the Calculation Date, the Prime Rate will be the rate on that Interest Determination Date as published in H.15 Daily Update opposite the caption "Bank Prime Loan."
- If the above rate is not published in either H.15(519) or the H.15 Daily Update by 3:00 p.m., New York City time, on the Calculation Date, the Calculation Agent will determine the Prime Rate to be the arithmetic mean of the rates of interest publicly announced by each bank that appears on the Reuters Screen USPRIME 1 Page, as defined below, as that bank's Prime Rate or base lending rate as in effect for that Interest Determination Date.
- If fewer than four rates for that Interest Determination Date appear on the Reuters Screen USPRIME 1 Page by 3:00 p.m., New York City time, on the Calculation Date, the Calculation Agent will determine the Prime Rate to be the arithmetic mean of the Prime Rates quoted on the basis of the actual number of days in the year divided by 360 as of the close of business on that Interest Determination Date by at least three major banks in The City of New York, which may include the Distribution Agents or their affiliates, selected by the Calculation Agent, after consultation with Morgan Stanley.
- If the banks selected by the Calculation Agent are not quoting as set forth above, the Prime Rate for that Interest Determination Date will remain the Prime Rate for the immediately preceding Interest Reset Period, or, if there was no Interest Reset Period, the rate of interest payable will be the Initial Interest Rate.

**"Reuters Screen USPRIME 1 Page"** means the display designated as page "USPRIME 1" on the Reuters Money 3000 Service, or any successor service, or any other page as may replace the USPRIME 1 Page on that service for the purpose of displaying Prime Rates or base lending rates of major U.S. banks.

#### *Treasury Rate Notes*

Treasury Rate Notes will bear interest at the interest rates specified in the Treasury Rate Notes and in the applicable Final Terms. That interest rate will be based on the Treasury Rate and any Spread and/or

Spread Multiplier and will be subject to the Minimum Interest Rate and the Maximum Interest Rate, if any.

The "**Treasury Rate**" means:

- the rate from the auction held on the applicable Interest Determination Date (the "**Auction**") of direct obligations of the United States ("**Treasury Bills**") having the Index Maturity specified in the applicable Final Terms as that rate appears under the caption "INVESTMENT RATE" on the display on Moneyline Telerate, or any successor service, on page 56 or any other page as may replace page 56 on that service ("**Telerate Page 56**") or page 57 or any other page as may replace page 57 on that service ("**Telerate Page 57**"); or
- if the rate described in the first bullet point is not published by 3:00 p.m., New York City time, on the Calculation Date, the bond equivalent yield of the rate for the applicable Treasury Bills as published in the H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the caption "U.S. Government Securities/Treasury Bills/Auction High"; or
- if the rate described in the second bullet point is not published by 3:00 p.m., New York City time, on the related Calculation Date, the bond equivalent yield of the auction rate of the applicable Treasury Bills, announced by the United States Department of the Treasury; or
- if the rate referred to in the third bullet point is not announced by the United States Department of the Treasury, or if the Auction is not held, the bond equivalent yield of the rate on the applicable interest determination date of Treasury Bills having the Index Maturity specified in the applicable Final Terms published in H.15(519) under the caption "U.S. Government Securities/Treasury Bills/Secondary Market"; or
- if the rate referred to in the fourth bullet point is not published by 3:00 p.m., New York City time, on the related Calculation Date, the rate on the applicable Interest Determination Date of the applicable Treasury Bills as published in H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the caption "U.S. Government Securities/Treasury Bills/Secondary Market"; or
- if the rate referred to in the fifth bullet point is not published by 3:00 p.m., New York City time, on the related Calculation Date, the rate on the applicable Interest Determination Date calculated by the Calculation Agent as the bond equivalent yield of the arithmetic mean of the secondary market bid rates, as of approximately 3:30 p.m., New York City time, on the applicable Interest Determination Date, of three primary U.S. government securities dealers, which may include the Distribution Agents or their affiliates, selected by the Calculation Agent, for the issue of Treasury Bills with a remaining maturity closest to the Index Maturity specified in the applicable Final Terms; or
- if the dealers selected by the Calculation Agent are not quoting as set forth above, the Treasury Rate for that Interest Determination Date will remain the Treasury Rate for the immediately preceding Interest Reset Period, or, if there was no Interest Reset Period, the rate of interest payable will be the Initial Interest Rate.

The "**bond equivalent yield**" means a yield calculated in accordance with the following formula and expressed as a percentage:

$$\text{Bond Equivalent Yield} = \frac{D \times N}{360 - (D \times M)} \times 100$$

where "D" refers to the applicable per annum rate for Treasury Bills quoted on a bank discount basis, "N" refers to 365 or 366, as the case may be, and "M" refers to the actual number of days in the interest period for which interest is being calculated.

#### *CMT Rate Notes*

CMT Rate Notes will bear interest at the interest rates specified in the CMT Rate Notes and in the applicable Final Terms. That interest rate will be based on the CMT Rate and any Spread and/or Spread Multiplier and will be subject to the Minimum Interest Rate and the Maximum Interest Rate, if any.

The "**CMT Rate**" means, for any Interest Determination Date, the rate displayed on the Designated CMT Telerate Page, as defined below, under the caption "... Treasury Constant Maturities ... Federal Reserve Board Release H.15... Mondays Approximately 3:45 p.m.," under the column for the Designated CMT Maturity Index, as defined below, for:

- (1) the rate on that Interest Determination Date, if the Designated CMT Telerate Page is 7051; and
- (2) the week or the month, as applicable, ended immediately preceding the week in which the related Interest Determination Date occurs, if the Designated CMT Telerate Page is 7052.

The following procedures will be followed if the CMT Rate cannot be determined as described above:

- If the above rate is no longer displayed on the relevant page, or if not displayed by 3:00 p.m., New York City time, on the Calculation Date, then the CMT Rate will be the Treasury Constant Maturity rate for the Designated CMT Maturity Index as published in the relevant H.15(519).
- If the above rate described in the first bullet point is no longer published, or if not published by 3:00 p.m., New York City time, on the related Calculation Date, then the CMT Rate will be the Treasury Constant Maturity Rate for the Designated CMT Maturity Index or other U.S. Treasury rate for the Designated CMT Maturity Index, on the Interest Determination Date for the related Interest Reset Date as may then be published by either the Board of Governors of the Federal Reserve System or the United States Department of the Treasury that the Calculation Agent determines to be comparable to the rate formerly displayed on the Designated CMT Telerate Page and published in the relevant H.15(519).
- If the information set forth above is not provided by 3:00 p.m., New York City time, on the related Calculation Date, then the Calculation Agent will determine the CMT Rate to be a yield to maturity, based on the arithmetic mean of the secondary market closing offer side prices as of approximately 3:30 p.m., New York City time, on the Interest Determination Date reported, according to their written records, by three leading primary U.S. government securities dealers (the "**Reference Dealers**") in The City of New York, which may include the Distribution Agents or their affiliates, selected by the Calculation Agent as described in the following sentence. The Calculation Agent will select five Reference Dealers, after consultation with Morgan Stanley, and will eliminate the highest quotation or, in the event of equality, one of the highest, and the lowest quotation or, in the event of equality, one of the lowest, for the most recently issued direct noncallable fixed rate obligations of the United States ("**Treasury Notes**") with an original maturity of approximately the Designated CMT Maturity Index, a remaining term to maturity of no more than 1 year shorter than the Designated CMT Maturity Index and in a principal amount that is representative for a single transaction in the securities in that market at that time. If two Treasury Notes with an original maturity as described above have remaining terms to maturity equally close to the Designated CMT Maturity Index, the quotes for the Treasury Note with the shorter remaining term to maturity will be used.

- If the Calculation Agent cannot obtain three Treasury Notes quotations as described in the immediately preceding sentence, the Calculation Agent will determine the CMT Rate to be a yield to maturity based on the arithmetic mean of the secondary market offer side prices as of approximately 3:30 p.m., New York City time, on the Interest Determination Date of three Reference Dealers in The City of New York, selected using the same method described in the immediately preceding sentence, for Treasury Notes with an original maturity equal to the number of years closest to but not less than the Designated CMT Maturity Index and a remaining term to maturity closest to the Designated CMT Maturity Index and in a principal amount that is representative for a single transaction in the securities in that market at that time.
- If three or four, and not five, of the Reference Dealers are quoting as described above, then the CMT Rate will be based on the arithmetic mean of the offer prices obtained and neither the highest nor the lowest of those quotes will be eliminated.
- If fewer than three Reference Dealers selected by the Calculation Agent are quoting as described above, the CMT Rate for that Interest Determination Date will remain the CMT Rate for the immediately preceding Interest Reset Period, or, if there was no Interest Reset Period, the rate of interest payable will be the Initial Interest Rate.

**"Designated CMT Telerate Page"** means the display on Moneyline Telerate, or any successor service, on the page designated in the applicable Final Terms or any other page as may replace that page on that service for the purpose of displaying Treasury Constant Maturities as reported in H.15(519). If no page is specified in the applicable Final Terms, the Designated CMT Telerate Page will be 7052, for the most recent week.

**"Designated CMT Maturity Index"** means the original period to maturity of the U.S. Treasury Securities, which is either 1, 2, 3, 5, 7, 10, 20 or 30 years, as specified in the applicable Final Terms, for which the CMT Rate will be calculated. If no maturity is specified in the applicable Final Terms, the Designated CMT Maturity Index will be two years.

### **Exchangeable Notes**

Morgan Stanley may issue Notes that are optionally or mandatorily exchangeable (the **"Exchangeable Notes"**) into:

- the securities of an entity not affiliated with Morgan Stanley;
- a basket of those securities;
- an index or indices of those securities; or
- any combination of the above.

The Exchangeable Notes may or may not bear interest or be issued with original issue discount or at a premium. The general terms of the Exchangeable Notes are as described below. The particular terms of any Exchangeable Notes, including the procedures for exercising any exchange right and for calculating and delivering any securities to be delivered upon exchange, will be set forth in the applicable Final Terms.

*Optionally Exchangeable Notes.* The holder of an optionally Exchangeable Note (the **"Optionally Exchangeable Notes"**) may, during a period, or at specific times, exchange the Notes for the underlying property at a specified rate of exchange. If specified in the applicable Final Terms, Morgan Stanley will have the option to redeem the Optionally Exchangeable Note prior to maturity. If the holder of an Optionally Exchangeable Note does not elect to exchange the Note prior to maturity or any applicable

redemption date, the holder will receive the principal amount of the Note plus any accrued interest at maturity or upon redemption.

*Credit-linked Notes.* Morgan Stanley may issue Credit-Linked Notes. The terms of Credit-Linked Notes will be specified in the applicable Final Terms.

*Mandatorily Exchangeable Notes.* At maturity, the holder of a mandatorily Exchangeable Note (the "**Mandatorily Exchangeable Notes**") must exchange the Note for the underlying property at a specified rate of exchange, and, therefore, depending upon the value of the underlying property at maturity, the holder of a Mandatorily Exchangeable Note may receive less than the principal amount of the Note at maturity. If so indicated in the applicable Final Terms, the specified rate at which a Mandatorily Exchangeable Note may be exchanged may vary depending on the value of the underlying property so that, upon exchange, the holder participates in a percentage, which may be less than, equal to, or greater than 100% of the change in value of the underlying property. Mandatorily Exchangeable Notes may include Notes where Morgan Stanley has the right, but not the obligation, to require holders of Notes to exchange the Notes for the underlying property.

*Payments upon Exchange.* The applicable Final Terms will specify if upon exchange, at maturity or otherwise, the holder of an Exchangeable Note may receive, at the specified exchange rate, either the underlying property or the cash value of the underlying property. The underlying property may be the securities of either U.S. or foreign entities or both. The Exchangeable Notes may or may not provide for protection against fluctuations in the exchange rate between the currency in which that Note is denominated and the currency or currencies in which the market prices of the underlying security or securities are quoted. Exchangeable Notes may have other terms, which will be specified in the applicable Final Terms. Exchangeable Notes for which a holder may receive the underlying property will not be admitted to the Official List of the UK Listing Authority or admitted to trading on the regulated market for fixed income securities of the London Stock Exchange unless a supplement to the Base Prospectus about the underlying property has been approved by the UK Listing Authority.

*Special Requirements for Exchange of Global Notes.* If an Optionally Exchangeable Note is represented by a global bearer note or by definitive bearer notes that remain on deposit with a common depositary or common safekeeper, or specified depositary, as the case may be, for Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system, the beneficial owner must exercise the right to exchange through Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system. In order to ensure that Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system will timely exercise a right to exchange a particular Optionally Exchangeable Note or any portion of a particular Optionally Exchangeable Note, the beneficial owner of the Optionally Exchangeable Note must instruct the broker or other direct or indirect participant through which it holds an interest in that Optionally Exchangeable Note to notify Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system of its desire to exchange in accordance with the then applicable operating procedures of Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system. Different firms have different deadlines for accepting instructions from their customers. Each beneficial owner should consult the broker or other participant through which it holds an interest in an Optionally Exchangeable Note in order to ascertain the deadline for ensuring that timely notice will be delivered to Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system.

*Payments upon Acceleration of Maturity or upon Tax Redemption.* If the principal amount payable at maturity of any Exchangeable Note is declared due and payable prior to maturity as a result of an acceleration or tax redemption, the amount payable on:

- an Optionally Exchangeable Note will equal the face amount of the Note plus accrued but unpaid interest, if any, to but excluding the date of payment, except that if a holder has exchanged an



Optionally Exchangeable Note prior to the date of declaration without having received the amount due upon exchange, the amount payable will be an amount of cash equal to the amount due upon exchange and will not include any accrued but unpaid interest; and

- a Mandatorily Exchangeable Note will equal an amount in cash determined as if the date of declaration were the maturity date, plus accrued interest, if any, to but excluding the date of payment.

### **Credit-Linked Notes, Commodity-Linked Notes and Equity-Linked Notes**

Morgan Stanley may issue Notes with the principal amount payable on any principal payment date and/or the amount of interest payable on any Interest Payment Date to be determined by reference to the credit of one or more specified entities not affiliated with Morgan Stanley, to one or more commodity prices, securities of entities not affiliated with Morgan Stanley (as well as, in the case of Series B Notes, securities of an entity that is affiliated with Morgan Stanley), baskets of those securities or indices of those securities. These Notes may include other terms, which will be specified in the applicable Final Terms.

### **Currency-Linked Notes**

Morgan Stanley may issue Notes with the principal amount payable on any principal payment date, and/or the amount of interest payable on any interest payment date to be determined by reference to the value of one or more currencies as compared to the value of one or more other currencies. The applicable Final Terms will specify the following:

- information as to the one or more currencies to which the principal amount payable on any principal payment date or the amount of interest payable on any interest payment date is linked or indexed;
- the currency in which the face amount of the Currency-Linked Note is denominated (the "**Denominated Currency**");
- the currency in which principal on the Currency-Linked Note will be paid (the "**Payment Currency**");
- the interest rate per annum and the dates on which Morgan Stanley will make interest payments;
- specific historic exchange rate information and any currency risks relating to the specific currencies selected; and
- additional United States federal income tax considerations, if any.

The Denominated Currency and the Payment Currency may be the same currency or different currencies. Interest on Currency-Linked Notes will be paid in the Denominated Currency.

### **Redemption and Repurchase of Notes**

*Optional Redemption by Morgan Stanley.* The applicable Final Terms will indicate either that the Notes cannot be redeemed prior to maturity, other than as provided under " — Tax Redemption" below, or will indicate the terms of Morgan Stanley's option to redeem the Notes subject always to compliance with all applicable laws and regulations and the requirements of each listing authority, stock exchange and/or quotation system (if any) by which the relevant Notes have been admitted to listing, trading and/or quotation. Morgan Stanley will give notice of redemption as described below. The Notes, except for Amortizing Notes, will not be subject to any sinking fund.

*Notice of Redemption.* Unless otherwise specified in the applicable Final Terms, notice of redemption to holders of Notes will be published in the manner described under "Notices" below; *provided* that such notice of redemption shall also be given to holders of Notes who have filed their names and addresses with the Trustee within two years preceding such notice of redemption by first-class mail, postage prepaid, at least 30 days and not more than 60 days prior to the date fixed for redemption, or within the redemption notice period designated in the applicable Final Terms, to the address of each holder as that address appears upon the books maintained by the Trustee. The publication will not be less than 30 nor more than 60 days prior to the date fixed for redemption. The notice to the beneficial owners of Notes held only in global form may be made through the customary notice procedures of Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system. If a series of Notes is admitted to the Official List of the UK Listing Authority and admitted to trading on the regulated market for fixed income securities of the London Stock Exchange, appropriate notice will be published in London as required by the UK Listing Authority.

*Repayment at Option of Holder.* If applicable, the applicable Final Terms will indicate that the holder has the option to have Morgan Stanley repay the Notes on a date or dates specified prior to their maturity date. The repayment price will be equal to 100% of the principal amount of the Notes, together with accrued interest to the date of repayment. For Notes issued with original issue discount, the applicable Final Terms will specify the amount payable upon a repayment.

For Morgan Stanley to repay a Note, the applicable paying agent must receive at least 15 days but not more than 30 days prior to the repayment date, or within the repayment notice period designated in the applicable Final Terms, the Note with the form entitled "Option to Elect Repayment" on the reverse of the Note duly completed, together with any unmatured coupons.

Exercise of the repayment option by the holder of a Note will be irrevocable. The holder may exercise the repayment option for less than the entire principal amount of the Note but, in that event, the principal amount of the Note remaining outstanding after repayment must be an authorized denomination.

*Special Requirements for Optional Repayment of Global Notes.* If a Note is represented by a global bearer note or by definitive Notes that remain on deposit with a common depository or common safekeeper, or specified depository, as the case may be, for Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system, the beneficial owner must exercise the right to have Morgan Stanley repay that Note through Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system. In order to ensure that Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system will timely exercise a right to have Morgan Stanley repay a particular Note or any portion of a particular Note, the beneficial owner of the Note must instruct the broker or other direct or indirect participant through which it holds an interest in that Note to notify Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system of its desire to have Morgan Stanley repay such Note or any portion of such Note in accordance with the then applicable operating procedures of Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system. Different firms have different deadlines for accepting instructions from their customers. Each beneficial owner should consult the broker or other participant through which it holds an interest in a Note in order to ascertain the deadline for ensuring that timely notice will be delivered to Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system.

*Open Market Purchases by Morgan Stanley.* Morgan Stanley may purchase Notes at any price in the open market or otherwise. Notes so purchased by Morgan Stanley may, at the discretion of Morgan Stanley, be held or resold or surrendered to the Trustee for cancellation.

## Redenomination

*Application.* The following is applicable to the Notes only if specified in the applicable Final Terms as being applicable.

*Notice of redenomination.* If the country of the Specified Currency becomes or, announces its intention to become, a Member State of the European Communities which adopts the euro as its lawful currency in accordance with the Treaty (a "**Participating Member State**"), Morgan Stanley may, without the consent of the Noteholders, on giving at least 30 days' prior notice to the Noteholders and the paying agents, designate a date (the "**Redenomination Date**"), being an Interest Payment Date under the Notes falling on or after the date on which such country becomes a Participating Member State.

*Redenomination.* From the Redenomination Date:

- the Notes shall be deemed to be redenominated into euro in the denomination of euro 0.01 with a principal amount for each Note equal to the principal amount of that Note in the specified currency, converted into euro at the rate for conversion of such currency into euro established by the Council of the European Union pursuant to the Treaty (including compliance with rules relating to rounding in accordance with European Community regulations); *provided, however*, that, if Morgan Stanley determines that the then market practice in respect of the redenomination into euro 0.01 of internationally offered securities is different from that specified above, such provisions shall be deemed to be amended so as to comply with such market practice and Morgan Stanley shall promptly notify the Noteholders, each listing authority, stock exchange and/or quotation system (if any) by which the Notes have been admitted to listing, trading and/or quotation and the paying agents of such deemed amendments;
- if Notes have been issued in definitive form:
  - all unmatured coupons denominated in the Specified Currency (whether or not attached to the Notes) will become void with effect from the date (the "**Euro Exchange Date**") on which Morgan Stanley gives notice (the "**Euro Exchange Notice**") to the Noteholders that replacement Notes and coupons denominated in euro are available for exchange (provided that such Notes and coupons are available) and no payments will be made in respect thereof;
  - the payment obligations contained in all Notes denominated in the Specified Currency will become void on the Euro Exchange Date but all other obligations of Morgan Stanley thereunder shall remain in full force and effect; and
  - new Notes and coupons denominated in euro will be issued in exchange for Notes and coupons denominated in the Specified Currency in such manner as the Trustee may specify and as shall be notified to the Noteholders in the Euro Exchange Notice; and
- all payments in respect of the Notes (other than, unless the redenomination date is on or after such date as the Specified Currency ceases to be a sub-division of the euro, payments of interest in respect of periods commencing before the Redenomination Date) will be made solely in euro by check drawn on, or by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) maintained by the payee with, a bank in the principal financial center of any Member State of the European Communities.

*Interest.* Following redenomination of the Notes where Notes have been issued in definitive form, the amount of interest due in respect of the Notes will be calculated by reference to the aggregate principal amount of the Notes presented (or, as the case may be, in respect of which coupons are presented) for payment by the relevant holder.

*Interest Determination Date.* If the Note is a Floating Rate Note, with effect from the redenomination date the Interest Determination Date shall be deemed to be the second TARGET Settlement Day before the first day of the relevant Interest Period.

## **Tax Redemption**

*All Notes.* Notes may be redeemed as a whole (but not in part), at the option of Morgan Stanley at any time prior to maturity, upon the giving of a notice of redemption as described below if Morgan Stanley determines that, as a result of:

- any change in or amendment to the laws, (including a holding, judgment or order by a court of competent jurisdiction), or any regulations or rulings promulgated under the laws, of the United States or of any political subdivision or taxing authority of or in the United States affecting taxation, or
- any change in official position regarding the application or interpretation of the laws, regulations or rulings referred to above,

which change or amendment becomes effective on or after the date of the applicable Final Terms in connection with the issuance of the Notes or any other date specified in the applicable Final Terms, Morgan Stanley is or will become obligated to pay Additional Amounts with respect to the Notes, as described below under " — Payment of Additional Amounts." The redemption price will be equal to 100% of the principal amount of the Notes, except as otherwise specified in the applicable Final Terms or unless the Note is a Discount Note or an Exchangeable Note, together with accrued interest to the date fixed for redemption. See "Description of New York Law Notes — Interest and Principal Payments—Original Issue Discount Notes" and "Exchangeable Notes—Payments upon Acceleration of Maturity or upon Tax Redemption" above for information on Exchangeable Notes. Morgan Stanley will give notice of any tax redemption.

Prior to giving notice of tax redemption, Morgan Stanley will deliver to the Trustee, with a copy to the Principal Paying Agent:

- a certificate stating that Morgan Stanley is entitled to effect the redemption and setting forth a statement of facts showing that the conditions precedent to the right of Morgan Stanley to so redeem have occurred (the date on which that certificate is delivered to the Trustee is the "**Redemption Determination Date**"); and
- an opinion of independent legal counsel of recognized standing to that effect based on the statement of facts.

Notice of redemption will be given not less than 30 nor more than 60 days prior to the date fixed for redemption. The date and the applicable redemption price will be specified in the notice, which will be given in accordance with " — Notices" below.

If any date fixed for redemption is a date prior to the date (the "**Exchange Date**") that is 40 days after the date on which Morgan Stanley receives the proceeds of the sale of a Note, definitive bearer notes will be issuable on and after that redemption date as if that redemption date had been the Exchange Date. Receipt of Ownership Certificates described under " — Forms of Notes," is a condition precedent to delivery of definitive bearer notes.

*Special Tax Redemption.* If Morgan Stanley determines that any payment made outside the United States by Morgan Stanley or any paying agent of principal, premium, interest and/or supplemental amounts, if any, due on any bearer note or coupon would, under any present or future laws or regulations of the United States, be subject to any certification, identification or other information reporting requirement of

any kind, the effect of which is the disclosure to Morgan Stanley, any paying agent or any governmental authority of the nationality, residence or identity of a beneficial owner of that bearer note or coupon who is a United States Alien (as defined below) other than such a requirement that:

- would not be applicable to a payment made by Morgan Stanley or any paying agent
  - directly to the beneficial owner or
  - to a custodian, nominee or other agent of the beneficial owner, unless the payment by the custodian, nominee or agent to the beneficial owner would otherwise be subject to any similar requirement, or
- can be satisfied by the custodian, nominee or other agent certifying to the effect that the beneficial owner is a United States Alien, unless the payment by the custodian, nominee or agent to the beneficial owner would otherwise be subject to any similar requirement,

Morgan Stanley will (i) redeem the Notes, as a whole, at a redemption price equal to 100% of the principal amount thereof (except as otherwise specified in the applicable Final Terms or unless the Note is an Original Issue Discount Note or Exchangeable Note), together with accrued interest to the date fixed for redemption, or (ii) at the election of Morgan Stanley, if the conditions described below in " —Election to Pay Additional Amounts Rather than Redeem," are satisfied, pay the Additional Amounts specified in that paragraph.

The term "**United States Alien**" means any person who, for United States federal income tax purposes, is a foreign corporation, a nonresident alien individual, a nonresident alien fiduciary of a foreign estate or trust, or a foreign partnership one or more of the members of which is a foreign corporation, a nonresident alien individual or a nonresident alien fiduciary of a foreign estate or trust.

Morgan Stanley will make the determination and election described above as soon as practicable and publish prompt notice thereof (the "**Determination Notice**") stating:

- the effective date of the certification, identification or other information reporting requirements;
- whether Morgan Stanley will redeem the Notes or has elected to pay the additional amounts specified in " — Election to Pay Additional Amounts Rather than Redeem" below; and
- if Morgan Stanley elects to redeem, the last date by which the redemption of the Notes must take place.

If Morgan Stanley redeems the Notes for this reason, the redemption will take place on a date not later than one year after the publication of the Determination Notice. Morgan Stanley will elect the date fixed for redemption by notice to the Trustee, with a copy to the Principal Paying Agent, at least 60 days prior to the date fixed for redemption, or within the redemption notice period specified in the applicable Final Terms. Notice of the redemption of the Notes will be given to the Noteholders not more than 60 nor less than 30 days prior to the date fixed for redemption, or within the redemption notice period specified in the applicable Final Terms.

Notwithstanding the foregoing, Morgan Stanley will not redeem the Notes if Morgan Stanley subsequently determines, not less than 30 days prior to the date fixed for redemption, or prior to the last day of the specified redemption notice period in the applicable Final Terms, that subsequent payments would not be subject to any certification, identification or other information reporting requirement, in which case Morgan Stanley will publish prompt notice of the determination and revoke any earlier redemption notice.

*Election to Pay Additional Amounts Rather than Redeem.* If and so long as the certification, identification or other information reporting requirements referred to in " — Special Tax Redemption" would be fully satisfied by payment of a withholding tax or similar charge, Morgan Stanley may elect to pay such additional amounts as may be necessary so that every net payment made outside the United States following the effective date of those requirements by Morgan Stanley, the Principal Paying Agent or any other paying agent of principal, premium, interest and/or supplemental amounts, if any, due in respect of any Note or any coupon of which the beneficial owner is a United States Alien will not be less than the amount provided for in the bearer note or coupon to be then due and payable after deduction or withholding for or on account of the withholding tax or similar charge, other than a withholding tax or similar charge that:

- would not be applicable in the circumstances referred to in the bullet points in the first paragraph following the heading " — Special Tax Redemption"; or
- is imposed as a result of presentation of the Note or Coupon for payment more than 15 days after the date on which the payment becomes due and payable or on which payment thereof is duly provided for, whichever occurs later.

Morgan Stanley's ability to elect to pay additional amounts as described in this paragraph is conditioned on there not being a requirement that the nationality, residence or identity of the beneficial owner be disclosed to Morgan Stanley, any paying agent or any governmental authority, as a result of the payment of the additional amounts.

If Morgan Stanley elects to pay any additional amounts as described in " — Election to Pay Additional Amounts Rather than Redeem," Morgan Stanley will have the right to redeem the bearer notes as a whole at any time by meeting the same conditions described in " — Special Tax Redemption," and the redemption price of the bearer notes will not be reduced for applicable withholding taxes. If Morgan Stanley elects to pay additional amounts as described in " — Election to Pay Additional Amounts Rather than Redeem," and the condition specified in the first sentence of " — Election to Pay Additional Amounts Rather than Redeem," should no longer be satisfied, then Morgan Stanley will redeem the bearer notes as a whole under the applicable provisions of " — Special Tax Redemption."

### **Payment of Additional Amounts**

*Additional Amounts.* Except as otherwise provided in the applicable Final Terms, Morgan Stanley will, subject to certain exceptions and limitations set forth below, pay those additional amounts (the "**Additional Amounts**") to the Noteholders or holders of any coupon issued with a bearer note who is a United States Alien as may be necessary in order that every net payment of the principal of and interest on the Note and any other amounts payable on the Note after withholding for or on account of any present or future tax, assessment or governmental charge imposed upon or as a result of that payment by the United States or any political subdivision or taxing authority thereof or therein, will not be less than the amount provided for in the Note or Coupon to be then due and payable under the Notes.

Morgan Stanley will not, however, be required to make any payment of Additional Amounts to any holder for or on account of:

- any present or future tax, assessment or other governmental charge that would not have been so imposed but for
  - the existence of any present or former connection between the holder, or between a fiduciary, settlor, beneficiary, member or shareholder of the holder, if the holder is an estate, a trust, a partnership or a corporation, and the United States and its possessions, including, without limitation, the holder, or such fiduciary, settlor, beneficiary, member or shareholder, being or having been a citizen or resident of the United States or being or

having been engaged in a trade or business or present in the United States or having, or having had, a permanent establishment in the United States, or

- the presentation by the holder of any Note or Coupon for payment on a date more than 15 days after the date on which payment became due and payable or the date on which payment thereof is duly provided for, whichever occurs later;
- any estate, inheritance, gift, sales, transfer, capital gains, corporation, income or personal property tax or any similar tax, assessment or governmental charge;
- any tax, assessment or other governmental charge imposed by reason of the holder's past or present status as a personal holding company or foreign personal holding company or controlled foreign corporation or passive foreign investment company with respect to the United States or as a corporation that accumulates earnings to avoid United States federal income tax or as a private foundation or other tax-exempt organization;
- any tax, assessment or other governmental charge that is payable otherwise than by withholding from payments on or in respect of any Note;
- any tax, assessment or other governmental charge required to be withheld by any paying agent from any payment of principal of, or interest on, any Note, if that payment can be made without withholding by any other paying agent in a city in Western Europe;
- any tax, assessment or other governmental charge that would not have been imposed but for the failure to comply with certification, information or other reporting requirements concerning the nationality, residence or identity of the holder or beneficial owner of that Note, if compliance is required by statute or by regulation of the United States or of any political subdivision or taxing authority thereof or therein as a precondition to relief or exemption from the tax, assessment or other governmental charge;
- any tax, assessment or other governmental charge imposed by reason of the holder's past or present status as the actual or constructive owner of 10% or more of the total combined voting power of all classes of stock entitled to vote of Morgan Stanley or as a direct or indirect subsidiary of Morgan Stanley; or
- any combination of the items listed above.

In addition, Morgan Stanley will not be required to make any payment of Additional Amounts with respect to any Note or Coupon presented for payment:

- where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note or Coupon to another paying agent in a member state of the European Union.

Nor will Additional Amounts be paid with respect to any payment on a Note to a United States Alien who is a fiduciary or partnership or other than the sole beneficial owner of that payment to the extent that payment would be required by the laws of the United States (or any political subdivision thereof) to be included in the income, for tax purposes, of a beneficiary or settlor with respect to the fiduciary or a

member of that partnership or a beneficial owner who would not have been entitled to the Additional Amounts had that beneficiary, settlor, member or beneficial owner been the Noteholder.

### **Replacement of Notes and Coupons**

Any Notes or coupons that become mutilated, destroyed, lost or stolen or are apparently destroyed, lost or stolen will be replaced by Morgan Stanley at the expense of the holder upon delivery of those Notes or coupons or satisfactory evidence of the destruction, loss or theft thereof to Morgan Stanley, the Principal Paying Agent or any other paying agent and the Trustee. In each case, an indemnity satisfactory to Morgan Stanley, the Principal Paying Agent or any other paying agent and the Trustee may be required at the expense of the holder of that Note or Coupon before a replacement Note or Coupon will be issued.

### **Notices**

*Notices to Holders of Bearer Notes.* Except as provided in the next sentence, Morgan Stanley will publish notices to holders of bearer notes in a newspaper in the English language of general circulation in The City of London. Morgan Stanley may give notice to the beneficial owners of bearer notes held only in global form through the customary notice procedures of Euroclear, Clearstream, Luxembourg or, as applicable, any other relevant clearing system, in which case Morgan Stanley will not publish the notice in a newspaper unless required to by law or stock exchange or other relevant authority regulation. Those notices will be deemed to have been given on the date of that publication (or other transmission, as applicable) or, if published in those newspapers on different dates, on the date of the first publication.

### **Governing Law**

The New York Law Notes and the Indenture will be governed by, and construed in accordance with, the laws of the State of New York.

### **Indenture**

References in parentheses below are to sections in the Indenture. Wherever particular sections or defined terms of the Indenture are referred to, those sections or defined terms of the Indenture that are incorporated herein by reference as part of the statement made, and the statement is qualified in its entirety by such reference.

### **Covenants Restricting Mergers and Other Significant Actions**

*Merger, Consolidation, Sale, Lease or Conveyance.* The Indenture provides that Morgan Stanley will not merge or consolidate with any other person and will not sell, lease or convey all or substantially all of its assets to any person, unless:

- Morgan Stanley will be the continuing corporation
- or
- the successor corporation or person that acquires all or substantially all of its assets:
  - if a successor to Morgan Stanley, will be a corporation organized under the laws of the United States, a state of the United States or the District of Columbia; and
  - will expressly assume all of the obligations of Morgan Stanley under the Indenture and the Notes issued under the Indenture; and



- immediately after the merger, consolidation, sale, lease or conveyance, Morgan Stanley, that person or that successor corporation will not be in default in the performance of the covenants and conditions of the Indenture applicable to Morgan Stanley. (Section 9.01)

*Absence of Protections Against All Potential Actions of Morgan Stanley.* There are no covenants or other provisions in the Indenture that would afford Noteholders additional protection in the event of a recapitalization transaction, a change of control of Morgan Stanley or a highly leveraged transaction. The merger covenant described above would only apply if the recapitalization transaction, change of control or highly leveraged transaction were structured to include a merger or consolidation of Morgan Stanley or a sale, lease or conveyance of all or substantially all of the assets of Morgan Stanley. However, Morgan Stanley may provide specific protections, such as a put right or increased interest, for particular Notes, which Morgan Stanley would describe in the applicable Final Terms.

## **Events of Default**

The Indenture provides Noteholders with certain remedies if Morgan Stanley fails to perform specific obligations, such as making payments on the Notes or other indebtedness, or if Morgan Stanley becomes bankrupt. Holders should review these provisions and understand which of Morgan Stanley's actions trigger an Event of Default and which actions do not. The Indenture provisions permit the issuance of Notes in one or more series, and, in many cases, whether an Event of Default has occurred is determined on a series by series basis.

An Event of Default is defined under the Indenture, with respect to any series of Notes issued under the Indenture, as being:

- default in payment for seven days of any principal, premium of the Notes of that series, either at maturity or upon any redemption, by declaration or otherwise;
- default for 30 days in payment of any interest and/or supplemental amount payable in accordance with the terms of the Notes of that series;
- default in the observance or performance of any other covenant of Morgan Stanley or agreement in the Notes of that series or the Indenture other than a covenant included solely for the benefit of a different series of Notes and continuance of that default for a period of 60 days after written notice thereof to Morgan Stanley by the Trustee, or to Morgan Stanley and the Trustee by the holders of not less than 25% in principal amount of the outstanding Notes affected thereby; and
- events of bankruptcy, insolvency or reorganization.

*Acceleration of Notes upon Event of Default.* The Indenture provides that:

- if an Event of Default due to the default in payment of principal of, or any premium or interest on or supplemental amount due with respect to, any series of Notes issued under the Indenture, or due to the default in the performance or breach of any other covenant or warranty of Morgan Stanley applicable to the Notes of that series but not applicable to all outstanding Notes issued under that Indenture occurs and is continuing, either the Trustee or the holders of not less than 25% in aggregate principal amount of the outstanding Notes of each affected series issued under the Indenture (treated as one class) by notice in writing to Morgan Stanley may declare the principal of all Notes of each affected series and interest accrued thereon to be due and payable immediately; and
- if an Event of Default due to a default in the performance of any other covenants or agreements in the Indenture applicable to all outstanding Notes issued under the Indenture or due to certain events of bankruptcy, insolvency or reorganization of Morgan Stanley will have occurred and be

continuing, either the Trustee or the holders of not less than 25% in aggregate principal amount of all outstanding Notes issued under the Indenture (treated as one class) may declare the principal of all those Notes and interest accrued thereon to be due and payable immediately. (Section 5.01)

*Annulment of Acceleration and Waiver of Defaults.* In some circumstances, if any and all Events of Default under the Indenture, other than the non-payment of the principal of the Notes that has become due as a result of an acceleration, have been cured, waived or otherwise remedied, then the holders of a majority in principal amount of all series of outstanding Notes affected (voting as one class) may annul past declarations of acceleration of or waive past defaults of the Notes. However, any continuing default in payment of principal of or any premium or interest on those Notes may not be waived. (Sections 5.01 and 5.10)

*Indemnification of Trustee for Certain Actions.* The Indenture contains a provision entitling the Trustee, subject to the duty of the Trustee during a default to act with the required standard of care, to be indemnified by the Noteholders issued under the Indenture before proceeding to exercise any right or power under the Indenture at the request of such holders. (Section 6.02) Subject to these provisions and some other limitations, the holders of a majority in principal amount of each series of outstanding Notes of each affected series, voting as one class, issued under the Indenture may direct the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred on the Trustee. (Section 5.09)

In connection with the exercise of its powers, trusts, authorities or discretions, the Trustee shall have regard to the interests of the holders of the relevant series of Notes affected or of all outstanding Notes affected, as the case may be, as a class. In particular, but without limitation, the Trustee shall not have regard to the consequences of such exercise for individual holders of the relevant series of Notes affected or of all outstanding Notes affected, as the case may be, resulting from such individual holders being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory. The Trustee shall not be entitled to require, nor shall any holder of the relevant series of Notes affected or of all outstanding Notes affected (as the case may be) be entitled to claim, from Morgan Stanley any indemnification or payment in respect of any tax consequence of any such exercise upon individual holders of the relevant series of Notes affected or of all outstanding Notes affected, as the case may be. (Sections 5.06 and 5.09)

*Limitation on Actions by an Individual Holder.* The Indenture provides that no individual holder of Notes issued under the Indenture may institute any action against Morgan Stanley under the Indenture, except actions for payment of overdue principal and interest, unless each of the following actions have occurred:

- the holder must have previously given written notice to the Trustee of the continuing default;
- the holders of not less than 25% in aggregate principal amount of each affected series of the outstanding Notes treated as one class, must have (i) requested the Trustee to institute that action and (ii) offered the Trustee reasonable indemnity;
- the Trustee must have failed to institute that action within 60 days of the request referred to above; and
- the holders of a majority in principal amount of the outstanding Notes of each affected series, treated as one class, must not have given directions to the Trustee inconsistent with those of the holders referred to above. (Sections 5.06 and 5.09)

*Annual Certification.* The Indenture contains a covenant that Morgan Stanley will file annually with the Trustee a certificate of no default or a certificate specifying any default that exists. (Section 3.05)

## Discharge, Defeasance and Covenant Defeasance

Morgan Stanley has the ability to eliminate most or all of its obligations on any series of Notes prior to maturity if it complies with the following provisions. (Section 10.01)

*Discharge of Indenture.* Morgan Stanley may discharge all of the obligations, other than as to transfers and exchanges, in the Indenture after Morgan Stanley has:

- paid or caused to be paid the principal and interest on all of the outstanding Notes in accordance with their terms;
- delivered to the Trustee for cancellation all of the outstanding Notes; or
- irrevocably deposited with the Trustee cash or U.S. government obligations in trust for the benefit of the holders of any series of Notes issued under the Indenture that have either become due and payable, or are by their terms due and payable, or are scheduled for redemption, within one year, in an amount certified to be sufficient to pay on each date that they become due and payable, the principal of and interest on, and any mandatory sinking fund payments for, those Notes, except that the deposit of cash or U.S. government obligations for the benefit of holders of a series of Notes that are due and payable, or are scheduled for redemption, within one year will discharge obligations under the Indenture relating only to that series of Notes.

*Defeasance of Notes at Any Time.* Morgan Stanley may also discharge all obligations, other than as to transfers and exchanges, under any series of Notes at any time ("**defeasance**"). However, Morgan Stanley may not, by defeasance, avoid any duty to register the transfer or exchange that series of Notes, to replace any mutilated, defaced, destroyed, lost, or stolen Notes of that series or to maintain an office or agency in respect of that series of Notes.

Morgan Stanley may be released with respect to any outstanding series of Notes from the obligations imposed by Sections 3.06 and 9.01, which Sections contain the covenants described above limiting liens and consolidations, mergers, asset sales and leases, and elect not to comply with those Sections without creating an Event of Default. Discharge under those procedures is called "covenant defeasance."

Defeasance or covenant defeasance may be effected only if, among other things:

- Morgan Stanley irrevocably deposits with the Trustee cash or, in the case of Notes payable only in U.S. dollars, U.S. government obligations, as trust funds in an amount certified to be sufficient to pay on each date that they become due and payable, the principal of and interest on, and any mandatory sinking fund payments for, all outstanding Notes of the series being defeased; and
- Morgan Stanley delivers to the Trustee an opinion of counsel to the effect that:
  - the holders of the series of Notes being defeased will not recognize income, gain or loss for United States federal income tax purposes as a result of the defeasance or covenant defeasance; and
  - the defeasance or covenant defeasance will not otherwise alter those holders' United States federal income tax treatment of principal and interest payments on the series of Notes being defeased.

In the case of a defeasance, this opinion must be based on a ruling of the Internal Revenue Service or a change in United States federal income tax law occurring after the date of this Base Prospectus, since such a result would not occur under current tax law.

## **Substitution for Morgan Stanley**

Subject to such amendment of the Indenture and such other conditions as Morgan Stanley may agree with the Trustee, but without the consent of the Noteholders or any series or the holders of the coupons appertaining thereto (if any), Morgan Stanley may, subject to such Notes and the coupons appertaining thereto being unconditionally and irrevocably guaranteed by Morgan Stanley, substitute a subsidiary of Morgan Stanley in place of Morgan Stanley as principal debtor under such Notes and the coupons appertaining thereto (if any) and the Indenture. (Sections 8.01 and 13.01)

Any Notes issued by a substitute issuer will be fully and unconditionally guaranteed pursuant to a guarantee of Morgan Stanley as to the payment of principal of, premium, interest and supplemental amounts, if any, and any Additional Amounts (as defined above) on those Notes when and as the same will become due and payable, whether at maturity or otherwise. See "Description of New York Law Notes—Payment of Additional Amounts." Under the terms of the guarantee, Noteholders will not be required to exercise their remedies against the substitute issuer prior to proceeding directly against Morgan Stanley. (Section 13.01)

## **Modification of the Indenture**

*Modification Without Consent of Holders.* Morgan Stanley and the Trustee may enter into supplemental indentures without the consent of the Noteholders to:

- secure any Notes;
- evidence the assumption by a successor corporation of the obligations of Morgan Stanley;
- evidence the assumption of a substitute issuer, in accordance with the provision described under " — Substitution for Morgan Stanley" above;
- add covenants for the protection of the Noteholders;
- cure any ambiguity or correct any inconsistency;
- establish the forms or terms of Notes of any series; and
- evidence the acceptance of appointment by a successor Trustee. (Section 8.01)

*Modification with Consent of Holders.* Morgan Stanley and the Trustee may, with the consent of the holders of not less than a majority in aggregate principal amount of each affected series of outstanding Notes (voting as one class), add any provisions to, or change in any manner or eliminate any of the provisions of, the Indenture or modify in any manner the rights of the holders of those Notes. However, none of the following changes may be made to any outstanding Note without the consent of each holder that would be affected by such change:

- extend the final maturity of the principal;
- reduce the principal amount;
- reduce the rate or extend the time of payment of interest;
- reduce any amount payable on redemption;
- change the currency in which the principal, including any amount of original issue discount, premium, or interest thereon is payable;

- modify or amend the provisions for conversion of any currency into another currency;
- reduce the amount of any original issue discount security payable upon acceleration or provable in bankruptcy;
- alter the terms on which Noteholders may convert or exchange Notes for stock or other securities of Morgan Stanley or of other entities or for other property or the cash value of the property, other than in accordance with the antidilution provisions or other similar adjustment provisions included in the terms of the Notes;
- alter the terms by which any supplemental amounts are determined, other than in accordance with the antidilution provisions or other similar adjustment provisions included in the terms of the Notes;
- impair the right to institute suit for the enforcement of any payment on any debt security when due; or
- reduce the percentage of Notes the consent of whose owners is required for modification of the Indenture.

## TERMS AND CONDITIONS OF THE ENGLISH LAW NOTES

*The following is the text of the terms and conditions which, as supplemented by the applicable Final Terms, will be endorsed on each Note in definitive form issued by Morgan Stanley, Morgan Stanley (Jersey) Limited or Morgan Stanley B.V. under the Program that is specified as being governed by English law. The terms and conditions applicable to any Note in global form will differ from those terms and conditions which would apply to the Note were it in definitive form to the extent described under "Summary of Provisions Relating to the Notes while in Global Form" below.*

### 1. INTRODUCTION

- 1.1 *Program:* Morgan Stanley ("**Morgan Stanley**"), Morgan Stanley (Jersey) Limited ("**Morgan Stanley Jersey**") and Morgan Stanley B.V. ("**MSBV**") have established a Program (the "**Program**") for the issuance of up to U.S.\$ 20,000,000,000 in aggregate principal amount, *inter alia*, of notes which are expressed to be governed by, and construed in accordance with, English law (the "**Notes**"). References to the "**Issuer**" in these terms and conditions shall mean (i) if the Notes to which these terms and conditions apply are issued by Morgan Stanley, Morgan Stanley (ii) if the Notes to which these terms and conditions apply are issued by Morgan Stanley Jersey, Morgan Stanley Jersey or (iii) if the Notes to which these terms and conditions apply are issued by MSBV, MSBV. The payment obligations of each of Morgan Stanley Jersey and MSBV in respect of Notes issued by it under the Program are (unless otherwise specified in the applicable Final Terms) guaranteed by Morgan Stanley (in its capacity as Guarantor (the "**Guarantor**")) under the terms of a guarantee dated 10 June 2002 (the "**Guarantee**").
- 1.2 *Final Terms:* Notes issued under the Program are issued in series (each a "**Series**") and each Series may comprise one or more tranches (each a "**Tranche**") of Notes. Each Tranche is the subject of a set of Final Terms (each, "**Final Terms**") which supplement these terms and conditions (the "**Conditions**"). The terms and conditions applicable to any particular Tranche of Notes are these Conditions as supplemented by the applicable Final Terms. In the event of any inconsistency between these Conditions and the applicable Final Terms, the applicable Final Terms shall prevail.
- 1.3 *Issue and Paying Agency Agreement:* The Notes are the subject of an issue and paying agency agreement dated 30 November 2000 (such issue and paying agency agreement as modified and restated on 4 December 2001 and 14 June 2005 and as further modified and restated on • June 2006 and as from time to time further modified and/or restated, the "**Issue and Paying Agency Agreement**") between Morgan Stanley, Morgan Stanley Jersey, MSBV, JPMorgan Chase Bank, N.A., London Branch, as fiscal agent (the "**Fiscal Agent**," which expression includes any successor fiscal agent appointed from time to time in connection with the Notes), and J.P. Morgan Bank (Ireland) plc, as paying agent (together with the Fiscal Agent and any additional paying agents appointed pursuant thereto, the "**Paying Agents**," which expression includes any successor paying agents appointed from time to time in connection with the Notes). The Fiscal Agent is also appointed as initial calculation agent.
- 1.4 *The Notes:* All subsequent references in these Conditions to "Notes" are to the Notes which are the subject of the applicable Final Terms. Copies of the applicable Final Terms are available for inspection by Noteholders during normal business hours at the Specified Office of the Fiscal Agent, the initial Specified Office of which is set out below.
- 1.5 *Summaries:* Certain provisions of these Conditions are summaries of the Issue and Paying Agency Agreement and are subject to its detailed provisions. The holders of the Notes (the "**Noteholders**") and the holders of the related interest coupons, if any, (the "**Couponholders**" and the "**Coupons**", respectively) are bound by, and are deemed to have notice of, all the provisions of

the Issue and Paying Agency Agreement applicable to them. Copies of the Issue and Paying Agency Agreement are available for inspection by Noteholders during normal business hours at the Specified Offices of each of the Paying Agents, the initial Specified Offices of which are set out below.

## 2. INTERPRETATION

### 2.1 *Definitions:* In these Conditions the following expressions have the following meanings:

**"Accrual Yield"** has the meaning given in the applicable Final Terms;

**"Additional Financial Centre(s)"** means the city or cities specified as such in the applicable Final Terms;

**"Business Day"** means any day, other than a Saturday or Sunday, (a) that is neither a legal holiday nor a day on which banking institutions are authorized or required by law or regulation to close (x) in The City of New York or in London, or (y) for Notes denominated in a Specified Currency other than U.S. dollars, euro or Australian dollars, in the principal financial centre of the country of the Specified Currency, or (z) for Notes denominated in Australian dollars, in Sydney and (b) for Notes denominated in euro, a day that is also a TARGET Settlement Day;

**"Business Day Convention"**, in relation to any particular date, has the meaning given in the applicable Final Terms and, if so specified in the applicable Final Terms, may have different meanings in relation to different dates and, in this context, the following expressions shall have the following meanings:

- (i) **"Following Business Day Convention"** means that the relevant date shall be postponed to the first following day that is a Business Day;
- (ii) **"Modified Following Business Day Convention"** or **"Modified Business Day Convention"** means that the relevant date shall be postponed to the first following day that is a Business Day unless that day falls in the next calendar month in which case that date will be the first preceding day that is a Business Day;
- (iii) **"Preceding Business Day Convention"** means that the relevant date shall be brought forward to the first preceding day that is a Business Day;
- (iv) **"FRN Convention", "Floating Rate Convention" or "Eurodollar Convention"** means that each relevant date shall be the date which numerically corresponds to the preceding such date in the calendar month which is the number of months specified in the applicable Final Terms as the Specified Period after the calendar month in which the preceding such date occurred provided, however, that:
  - (a) if there is no such numerically corresponding day in the calendar month in which any such date should occur, then such date will be the last day which is a Business Day in that calendar month;
  - (b) if any such date would otherwise fall on a day which is not a Business Day, then such date will be the first following day which is a Business Day unless that day falls in the next calendar month, in which case it will be the first preceding day which is a Business Day; and
  - (c) if the preceding such date occurred on the last day in a calendar month which was a Business Day, then all subsequent such dates will be the last day which is a Business Day in the calendar month which is the specified

number of months after the calendar month in which the preceding such date occurred; and

- (v) **"No Adjustment"** means that the relevant date shall not be adjusted in accordance with any Business Day Convention;

**"Calculation Agent"** means, in respect of any Notes, the Fiscal Agent or such other Person specified in the applicable Final Terms as the party responsible for calculating the Rate(s) of Interest and Interest Amount(s) and/or, if agreed between Morgan Stanley and the Fiscal Agent, such other amount(s) as may be specified in the applicable Final Terms;

**"Cash Settlement Notes"** means Notes specified as being Notes to which Cash Settlement applies in the applicable Final Terms or Notes specified as being Notes to which either Physical Settlement or Cash Settlement applies in the applicable Final Terms and in respect of which the Noteholder or the Issuer, as the case may be, has not elected for Physical Settlement to apply;

**"Coupon Sheet"** means, in respect of a Note, a coupon sheet relating to the Note;

**"Day Count Fraction"** means (subject as provided in Condition 5), in respect of the calculation of an amount for any period of time (the **"Calculation Period"**), such day count fraction as may be specified in these Conditions or the applicable Final Terms and:

- (i) if **"Actual/365"** or **"Actual/Actual"** is so specified, means the actual number of days in the Calculation Period divided by 365 (or, if any portion of the Calculation Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Calculation Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Calculation Period falling in a non-leap year divided by 365);
- (ii) if **"Actual/365 (Fixed)"** is so specified, means the actual number of days in the Calculation Period divided by 365;
- (iii) if **"Actual/360"** is so specified, means the actual number of days in the Calculation Period divided by 360;
- (iv) if **"30/360"** is so specified, means the number of days in the Calculation Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless (i) the last day of the Calculation Period is the 31st day of a month but the first day of the Calculation Period is a day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day month, or (ii) the last day of the Calculation Period is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month));
- (v) if **"30E/360"** or **"Eurobond Basis"** is so specified, means the number of days in the Calculation Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months, without regard to the date of the first day or last day of the Calculation Period unless, in the case of the final Calculation Period, the date of final maturity is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month); and
- (vi) if **"Actual/ISMA"** is so specified, means:
  - (a) where the Calculation Period is equal to or shorter than the Regular Period during which it falls, the actual number of days in the Calculation Period divided by the



product of (1) the actual number of days in such Regular Period and (2) the number of Regular Periods in any year; and

(b) where the Calculation Period is longer than one Regular Period, the sum of:

(A) the actual number of days in such Calculation Period falling in the Regular Period in which it begins divided by the product of (1) the actual number of days in such Regular Period and (2) the number of Regular Periods in any year; and

(B) the actual number of days in such Calculation Period falling in the next Regular Period divided by the product of (1) the actual number of days in such Regular Period and (2) the number of Regular Periods in any year.

For this purpose, “**Regular Period**” means each period from and including a Regular Date falling in any year to but excluding the next Regular Date, where “**Regular Date**” means the day and month (but not the year) on which any Interest Payment Date falls.

“**Determination Agent**” means the entity specified as such in the applicable Final Terms. The Determination Agent shall act as an expert and not as an agent for the Issuer or the Noteholders. All determinations, considerations and decisions made by the Determination Agent shall, in the absence of manifest error, wilful default or bad faith, be final and conclusive and the Determination Agent shall have no liability in relation to such determinations except in the case of its wilful default or bad faith;

“**Early Redemption Amount**” means, in respect of any Note, its principal amount or such other amount payable by the Issuer in respect of such Note on early redemption as may be specified in, or determined in accordance with, these Conditions or the applicable Final Terms;

“**Extraordinary Resolution**” has the meaning given in the Issue and Paying Agency Agreement;

“**Final Redemption Amount**” means, in respect of any Note, its principal amount or such other amount as may be specified in, or determined in accordance with, the applicable Final Terms;

“**Fixed Coupon Amount**” has the meaning given in the applicable Final Terms;

“**Interest Amount**” means, in relation to a Note and an Interest Period, the amount of interest payable in respect of that Note for that Interest Period;

“**Interest Commencement Date**” means the Issue Date of the Notes or such other date as may be specified as the Interest Commencement Date in the applicable Final Terms;

“**Interest Determination Date**” has the meaning given in the applicable Final Terms;

“**Interest Payment Date**” means the date or dates specified as such in, or determined in accordance with the provisions of, the applicable Final Terms and, if a Business Day Convention is specified in the applicable Final Terms:

- (i) as the same may be adjusted in accordance with the relevant Business Day Convention; or
- (ii) if the Business Day Convention is the FRN Convention, Floating Rate Convention or Eurodollar Convention and an interval of a number of calendar months is specified in the applicable Final Terms as being the Specified Period, each of such dates as may occur in accordance with the FRN Convention, Floating Rate Convention or Eurodollar Convention at such Specified Period of calendar months following the Interest

Commencement Date (in the case of the first Interest Payment Date) or the previous Interest Payment Date (in any other case);

**"Interest Period"** means each period beginning on (and including) the Interest Commencement Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date;

**"ISDA Definitions"** means the 2000 ISDA Definitions, as amended and updated as at the date of issue of the first Tranche of the Notes of the relevant Series (as specified in the applicable Final Terms) as published by the International Swaps and Derivatives Association, Inc.;

**"Issue Date"** has the meaning given in the applicable Final Terms;

**"Margin"** has the meaning given in the applicable Final Terms;

**"Maturity Date"** has the meaning given in the applicable Final Terms;

**"Maximum Redemption Amount"** has the meaning given in the applicable Final Terms;

**"Minimum Redemption Amount"** has the meaning given in the applicable Final Terms;

**"Morgan Stanley Notes"** means all notes issued by Morgan Stanley;

**"MSBV Notes"** means all Notes issued by Morgan Stanley B.V.;

**"MSJ Notes"** means all Notes issued by Morgan Stanley (Jersey) Limited;

**"Optional Redemption Amount (Call)"** means, in respect of any Cash Settlement Note, its principal amount or such other amount as may be specified in, or determined in accordance with, the applicable Final Terms and, in respect of any Physical Settlement Note, the Physical Delivery Amount as may be specified in, or determined in accordance with, the applicable Final Terms;

**"Optional Redemption Amount (Put)"** means, in respect of any Cash Settlement Note, its principal amount or such other amount as may be specified in, or determined in accordance with, the applicable Final Terms and, in respect of any Physical Settlement Note, the Physical Delivery Amount as may be specified in, or determined in accordance with, the applicable Final Terms;

**"Optional Redemption Date (Call)"** has the meaning given in the applicable Final Terms;

**"Optional Redemption Date (Put)"** has the meaning given in the applicable Final Terms;

**"Participating Member State"** means a Member State of the European Communities which adopts the euro as its lawful currency in accordance with the Treaty;

**"Payment Business Day"** means:

- (i) if the currency of payment is euro, any day which is:
  - (a) a day on which banks in the relevant place of presentation are open for presentation and payment of bearer debt securities and for dealings in foreign currencies; and
  - (b) in the case of payment by transfer to an account, a TARGET Settlement Day and a day on which dealings in foreign currencies may be carried on in each (if any) Additional Financial Centre; or

- (ii) if the currency of payment is not euro, any day which is:
  - (a) a day on which banks in the relevant place of presentation are open for presentation and payment of bearer debt securities and for dealings in foreign currencies; and
  - (b) in the case of payment by transfer to an account, a day on which dealings in foreign currencies may be carried on in the Principal Financial Centre of the currency of payment and in each (if any) Additional Financial Centre;

**"Person"** means any individual, company, corporation, firm, partnership, joint venture, association, organization, state or agency of a state or other entity, whether or not having separate legal personality;

**"Physical Settlement Notes"** means Notes specified as being Notes to which Physical Settlement applies, or Notes specified as being Notes to which either Physical Settlement or Cash Settlement applies in the applicable Final Terms and in respect of which the Noteholder or the Issuer, as the case may be, has not elected for Cash Settlement to apply;

**"Principal Financial Centre"** means, in relation to any currency, the principal financial centre for that currency provided, however, that:

- (i) in relation to euro, it means the principal financial centre of such Member State of the European Communities as is selected (in the case of a payment) by the payee or (in the case of a calculation) by the Calculation Agent; and
- (ii) in relation to Australian dollars, it means Sydney and Melbourne and, in relation to New Zealand dollars, it means Wellington and Auckland;

**"Put Option Notice"** means a notice which must be delivered to a Paying Agent by any Noteholder wanting to exercise a right to redeem a Note at the option of the Noteholder;

**"Put Option Receipt"** means a receipt issued by a Paying Agent to a depositing Noteholder upon deposit of a Note with such Paying Agent by any Noteholder wanting to exercise a right to redeem a Note at the option of the Noteholder;

**"Rate of Interest"** means the rate or rates (expressed as a percentage per annum) of interest payable in respect of the Notes specified in applicable Final Terms or calculated or determined in accordance with the provisions of these Conditions and/or the applicable Final Terms;

**"Redemption Amount"** means, as appropriate, the Final Redemption Amount, the Optional Redemption Amount (Call), the Optional Redemption Amount (Put), the Early Redemption Amount, Physical Delivery Amount or such other amount in the nature of a redemption amount as may be specified in, or determined in accordance with the provisions of, the applicable Final Terms;

**"Redemption Expenses"** means, in respect of any Note or Notes, any expenses (other than in relation to Taxes) payable on or in respect of or in connection with the redemption of such Note or Notes;

**"Reference Asset"** means in respect of any Note, any Underlying Share or other non-cash asset, the price or level of which determines the Redemption Amount of such Note;

**"Reference Banks"** has the meaning given in the applicable Final Terms or, if none, four major banks selected by the Calculation Agent in the market that is most closely connected with the Reference Rate;

**"Reference Price"** has the meaning given in the applicable Final Terms;

**"Reference Rate"** has the meaning given in the applicable Final Terms;

**"Relevant Clearing System"** means, as appropriate, Euroclear, Clearstream, Luxembourg and/or such other relevant clearing system, as the case may be, through which interests in Notes are to be held and through an account at which the Notes are to be cleared, as specified in the applicable Final Terms;

**"Relevant Date"** means, in relation to any payment, whichever is the later of (a) the date on which the payment in question first becomes due and (b) if the full amount payable has not been received in the Principal Financial Centre of the currency of payment by the Fiscal Agent on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders;

**"Relevant Financial Centre"** has the meaning given in the applicable Final Terms;

**"Relevant Screen Page"** means the page, section or other part of a particular information service (including, without limitation, the Reuters Money 3000 Service and the Bridge's Telerate Service) specified as the Relevant Screen Page in the applicable Final Terms, or such other page, section or other part as may replace it on that information service or such other information service, in each case, as may be nominated by the Person providing or sponsoring the information appearing there for the purpose of displaying rates or prices comparable to the Reference Rate;

**"Relevant Time"** has the meaning given in the applicable Final Terms;

**"Reserved Matter"** means any proposal to change any date fixed for payment of principal or interest in respect of the Notes, to reduce the amount of principal or interest payable on any date in respect of the Notes, to alter the method of calculating the amount of any payment in respect of the Notes or the date for any such payment, to change the currency of any payment under the Notes or to change the quorum requirements relating to meetings or the majority required to pass an Extraordinary Resolution;

**"Specified Currency"** has the meaning given in the applicable Final Terms;

**"Specified Denomination(s)"** has the meaning given in the applicable Final Terms;

**"Specified Office"** has the meaning given in the Issue and Paying Agency Agreement;

**"Specified Period"** has the meaning given in the applicable Final Terms;

**"Subsidiary"** means, in relation to any Person (the **"first Person"**) at any particular time, any other Person (the **"second Person"**):

- (i) whose affairs and policies the first Person controls or has the power to control, whether by ownership of share capital, contract, the power to appoint or remove members of the governing body of the second Person or otherwise; or
- (ii) whose financial statements are, in accordance with applicable law and generally accepted accounting principles, consolidated with those of the first Person;

**"Talon"** means a talon for further Coupons;

**"TARGET Settlement Day"** means any day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System is open;

**"Taxes"** means any tax, duty, impost, levy, charge or contribution in the nature of taxation or any withholding or deduction for or on account thereof, including (but not limited to) any applicable stock exchange tax, turnover tax, stamp duty, stamp duty reserve tax and/or other taxes chargeable or payable in connection with any redemption of a Note and/or payment of the Redemption Amount and/or delivery of the Physical Delivery Amount and/or the transfer or delivery of Underlying Shares and/or the relevant Transfer Documentation;

**"Trade Date"** means in relation to any series of Notes, the date specified as such in the applicable Final Terms;

**"Transfer Documentation"** means, for each Series of Notes, such documentation as is generally acceptable for settlement of transfer of Underlying Shares on the relevant Exchange or through the Clearing System including, without limitation, stock notes and/or stock transfer forms in the case of settlement on the London Stock Exchange;

**"Treaty"** means the Treaty establishing the European Community, as amended;

**"Zero Coupon Note"** means a Note specified as such in the applicable Final Terms.

## 2.2 *Interpretation:* In these Conditions:

- (i) if the Notes are Zero Coupon Notes, references to Coupons and Couponholders are not applicable;
- (ii) if Talons are specified in the applicable Final Terms as being attached to the Notes at the time of issue, references to Coupons shall be deemed to include references to Talons;
- (iii) if Talons are not specified in the applicable Final Terms as being attached to the Notes at the time of issue, references to Talons are not applicable;
- (iv) any reference to principal shall be deemed to include the Redemption Amount, any additional amounts in respect of principal which may be payable under Condition 17 (*Taxation*), any premium payable in respect of a Note and any other amount in the nature of principal payable pursuant to these Conditions;
- (v) any reference to interest shall be deemed to include any additional amounts in respect of interest which may be payable under Condition 17 (*Taxation*) and any other amount in the nature of interest payable pursuant to these Conditions;
- (vi) references to Notes being "outstanding" shall be construed in accordance with the Issue and Paying Agency Agreement; and
- (vii) if an expression is stated in Condition 2.1 to have the meaning given in the applicable Final Terms, but the applicable Final Terms gives no such meaning or specifies that such expression is "not applicable" then such expression is not applicable to the Notes.

## 3. **FORM, DENOMINATION AND TITLE**

The Notes are in bearer form, serially numbered, in the Specified Denomination(s) with Coupons and, if specified in the applicable Final Terms, Talons attached at the time of issue. In the case of a Series of Notes with more than one Specified Denomination, Notes of one Specified Denomination will not be exchangeable for Notes of another Specified Denomination. In the case

of MSBV, each MSBV Note will be issued with a Specified Denomination of at least EUR 1,000 (or its equivalent in the currency in which such MSBV Note is denominated). Title to the Notes and the Coupons will pass by delivery. The holder of any Note or Coupon shall (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing thereon or any notice of any previous loss or theft thereof) and no Person shall be liable for so treating such holder.

#### 4. **STATUS**

4.1 *Status of the Notes:* The Notes constitute direct and general obligations of the Issuer which rank *pari passu* among themselves.

4.2 *Status of Guarantee:* The Guarantor's obligations in respect of the Notes (other than Notes the Final Terms relating to which specifies that such Notes are not guaranteed by Morgan Stanley) constitute direct and general obligations of the Guarantor which rank *pari passu* among themselves.

#### 5. **FIXED RATE NOTE PROVISIONS**

5.1 *Application:* This Condition 5 (*Fixed Rate Note Provisions*) is applicable to the Notes only if the Fixed Rate Note Provisions are specified in the applicable Final Terms as being applicable.

5.2 *Accrual of interest:* The Notes bear interest from the Interest Commencement Date at the Rate of Interest payable in arrear on each Interest Payment Date, subject as provided in Condition 14 (*Payments*). Each Note will cease to bear interest from the due date for final redemption unless, upon due presentation, payment of the Redemption Amount is improperly withheld or refused, in which case it will continue to bear interest in accordance with this Condition 5 (as well after as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

5.3 *Fixed Coupon Amount:* The amount of interest payable in respect of each Note for any Interest Period shall be the relevant Fixed Coupon Amount and, if the Notes are in more than one Specified Denomination, shall be the relevant Fixed Coupon Amount in respect of the relevant Specified Denomination.

5.4 *Regular Interest Periods:* If all of the Interest Payment Dates fall at regular intervals between the Issue Date and the Maturity Date, then:

5.4.1 the Notes shall for the purposes of this Condition 5 be "**Regular Interest Period Notes**";

5.4.2 the day and month (but not the year) on which any Interest Payment Date falls shall for the purposes of this Condition 5 be a "**Regular Date**"; and

5.4.3 each period from and including a Regular Date falling in any year to but excluding the next succeeding Regular Date shall for the purposes of this Condition 5 be a "**Regular Period**".

5.5 *Irregular first or last Interest Periods:* If the Notes would be Regular Interest Period Notes but for the fact that either or both of:

5.5.1 the interval between the Issue Date and the first Interest Payment Date; and

5.5.2 the interval between the Maturity Date and the immediately preceding Interest Payment Date

is longer or shorter than a Regular Period, then the Notes shall nevertheless be deemed to be Regular Interest Period Notes *provided, however*, that if the interval between the Maturity Date and the immediately preceding Interest Payment Date is longer or shorter than a Regular Period, the day and month on which the Maturity Date falls shall not be a "Regular Date".

- 5.6 *Irregular Interest Amount:* If the Notes are Regular Interest Period Notes, the amount of interest payable in respect of each Note for any period which is not a Regular Period shall be calculated by applying the Rate of Interest to the principal amount of such Note, multiplying the product by the relevant Day Count Fraction and rounding the resulting figure to the nearest sub-unit of the Specified Currency (half a sub-unit being rounded upwards). For this purpose a "**sub-unit**" means, in the case of any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, in the case of euro, means one cent.
- 5.7 *Day Count Fraction:* In respect of any period which is not a Regular Period the relevant day count fraction (the "**Day Count Fraction**") shall be determined in accordance with the following provisions:
- 5.7.1 if the Day Count Fraction is specified in the applicable Final Terms as being 30/360, the relevant Day Count Fraction will be the number of days in the relevant period (calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed) divided by 360;
- 5.7.2 if the Day Count Fraction is specified in the applicable Final Terms as being Actual/Actual (Bond) and the relevant period falls during a Regular Period, the relevant Day Count Fraction will be the number of days in the relevant period divided by the product of (A) the number of days in the Regular Period in which the relevant period falls and (B) the number of Regular Periods in any period of one year; and
- 5.7.3 the Day Count Fraction is specified in the applicable Final Terms as being Actual/Actual (Bond) and the relevant period begins in one Regular Period and ends in the next succeeding Regular Period, interest will be calculated on the basis of the sum of:
- (a) the number of days in the relevant period falling within the first such Regular Period divided by the product of (1) the number of days in the first such Regular Period and (2) the number of Regular Periods in any period of one year; and
  - (b) the number of days in the relevant period falling within the second such Regular Period divided by the product of (1) the number of days in the second such Regular Period and (2) the number of Regular Periods in any period of one year.
- 5.8 *Number of days:* For the purposes of this Condition 5, unless the Day Count Fraction is specified in the applicable Final Terms as being 30/360 (in which case the provisions of paragraph 5.7.1 above shall apply), the number of days in any period shall be calculated on the basis of actual calendar days from and including the first day of the relevant period to but excluding the last day of the relevant period.
- 5.9 *Irregular Interest Periods:* If the Notes are not Regular Interest Period Notes and interest is required to be calculated for any period other than an Interest Period, interest shall be calculated on such basis as is described in the applicable Final Terms.

**6. FLOATING RATE NOTE AND INDEX-LINKED INTEREST NOTE PROVISIONS**

6.1 *Application:* This Condition 6 (*Floating Rate Note and Index-Linked Interest Note Provisions*) is applicable to the Notes only if the Floating Rate Note Provisions or the Index-Linked Interest Note Provisions are specified in the applicable Final Terms as being applicable.

6.2 *Accrual of interest:* The Notes bear interest from the Interest Commencement Date at the Rate of Interest payable in arrear on each Interest Payment Date, subject as provided in Condition 14 (*Payments*). Each Note will cease to bear interest from the due date for final redemption unless, upon due presentation, payment of the Redemption Amount is improperly withheld or refused, in which case it will continue to bear interest in accordance with this Condition (as well after as before judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment). The Rate of Interest in respect of all or any Interest Periods shall if so specified in the applicable Final Terms be zero.

6.3 *Screen Rate Determination:* If Screen Rate Determination is specified in the applicable Final Terms as the manner in which the Rate(s) of Interest is/are to be determined, the Rate of Interest applicable to the Notes for each Interest Period will be determined by the Calculation Agent on the following basis:

6.3.1 if the Reference Rate is a composite quotation or customarily supplied by one entity, the Calculation Agent will determine the Reference Rate which appears on the Relevant Screen Page as of the Relevant Time on the relevant Interest Determination Date;

6.3.2 in any other case, the Calculation Agent will determine the arithmetic mean of the Reference Rates which appear on the Relevant Screen Page as of the Relevant Time on the relevant Interest Determination Date;

6.3.3 if, in the case of 6.3.1 above, such rate does not appear on that page or, in the case of 6.3.2 above, fewer than two such rates appear on that page or if, in either case, the Relevant Screen Page is unavailable, the Calculation Agent will:

(a) request the principal Relevant Financial Centre office of each the Reference Banks to provide a quotation of the Reference Rate at approximately the Relevant Time on the Interest Determination Date to prime banks in the Relevant Financial Centre interbank market in an amount that is representative for a single transaction in that market at that time; and

(b) determine the arithmetic mean of such quotations; and

6.3.4 if fewer than two such quotations are provided as requested, the Calculation Agent will determine the arithmetic mean of the rates (being the nearest to the Reference Rate, as determined by the Calculation Agent) quoted by major banks in the Principal Financial Centre of the Specified Currency, selected by the Calculation Agent, at approximately 11.00 a.m. (local time in the Principal Financial Centre of the Specified Currency) on the first day of the relevant Interest Period for loans in the Specified Currency to leading European banks for a period equal to the relevant Interest Period and in an amount that is representative for a single transaction in that market at that time,

and the Rate of Interest for such Interest Period shall be the sum of the Margin and the rate or (as the case may be) the arithmetic mean so determined; provided, however, that if the Calculation



Agent is unable to determine a rate or (as the case may be) an arithmetic mean in accordance with the above provisions in relation to any Interest Period, the Rate of Interest applicable to the Notes during such Interest Period will be the sum of the Margin and the rate (or as the case may be) the arithmetic mean last determined in relation to the Notes in respect of a preceding Interest Period.

- 6.4 *ISDA Determination:* If ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate(s) of Interest is/are to be determined, the Rate of Interest applicable to the Notes for each Interest Period will be the sum of the Margin and the relevant ISDA Rate where "ISDA Rate" in relation to any Interest Period means a rate equal to the Floating Rate (as defined in the ISDA Definitions) that would be determined by the Calculation Agent under an interest rate swap transaction if the Calculation Agent were acting as Calculation Agent for that interest rate swap transaction under the terms of an agreement incorporating the ISDA Definitions and under which:
- 6.4.1 the Floating Rate Option (as defined in the ISDA Definitions) is as specified in the applicable Final Terms;
  - 6.4.2 the Designated Maturity (as defined in the ISDA Definitions) is a period specified in the applicable Final Terms; and
  - 6.4.3 the relevant Reset Date (as defined in the ISDA Definitions) is either (A) if the relevant Floating Rate Option is based on the London inter-bank offered rate (LIBOR) for a currency, the first day of that Interest Period or (B) in any other case, as specified in the applicable Final Terms.
- 6.5 *Index-Linked Interest:* If the Index-Linked Interest Note Provisions are specified in the applicable Final Terms as being applicable, the Rate(s) of Interest applicable to the Notes for each Interest Period will be determined in the manner specified in the applicable Final Terms.
- 6.6 *Maximum or Minimum Rate of Interest:* If any Maximum Rate of Interest or Minimum Rate of Interest is specified in the applicable Final Terms, then the Rate of Interest shall in no event be greater than the maximum or be less than the minimum so specified.
- 6.7 *Calculation of Interest Amount:* The Calculation Agent will, as soon as practicable after the time at which the Rate of Interest is to be determined in relation to each Interest Period, calculate the Interest Amount payable in respect of each Note for such Interest Period. The Interest Amount will be calculated by applying the Rate of Interest for such Interest Period to the principal amount of such Note during such Interest Period and multiplying the product by the relevant Day Count Fraction.
- 6.8 *Calculation of other amounts:* If the applicable Final Terms specifies that any other amount is to be calculated by the Calculation Agent, the Calculation Agent will, as soon as practicable after the time or times at which any such amount is to be determined, calculate the relevant amount. The relevant amount will be calculated by the Calculation Agent in the manner specified in the applicable Final Terms.
- 6.9 *Publication:* The Calculation Agent will cause each Rate of Interest and Interest Amount determined by it, together with the relevant Interest Payment Date, and any other amount(s) required to be determined by it together with any relevant payment date(s) to be notified to the Paying Agents and each listing authority, stock exchange and/or quotation system (if any) by which the Notes have been admitted to listing, trading and/or quotation as soon as practicable after such determination but (in the case of each Rate of Interest, Interest Amount and Interest Payment Date) in any event not later than the first day of the relevant Interest Period. Notice thereof shall also promptly be given to the Noteholders. The Calculation Agent will be entitled to

recalculate any Interest Amount (on the basis of the foregoing provisions) without notice in the event of an extension or shortening of the relevant Interest Period.

- 6.10 *Notifications etc:* All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition by the Calculation Agent will (in the absence of manifest error) be binding on the Issuer, the Paying Agents, the Noteholders and the Couponholders and (subject as aforesaid) no liability to any such Person will attach to the Calculation Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions for such purposes.

## 7. **ZERO COUPON NOTE PROVISIONS**

- 7.1 *Application:* This Condition 7 (*Zero Coupon Note Provisions*) is applicable to the Notes only if the Zero Coupon Note Provisions are specified in the applicable Final Terms as being applicable.

- 7.2 *Late payment on Zero Coupon Notes:* If the Redemption Amount payable in respect of any Zero Coupon Note is improperly withheld or refused, the Redemption Amount shall thereafter be an amount equal to the sum of:

7.2.1 the Reference Price; and

7.2.2 the product of the Accrual Yield (compounded annually) being applied to the Reference Price from (and including) the Issue Date to (but excluding) whichever is the earlier of (i) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (ii) the day which is seven days after the Fiscal Agent has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

## 8. **DUAL CURRENCY NOTE PROVISIONS**

- 8.1 *Application:* This Condition 8 (*Dual Currency Note Provisions*) is applicable to the Notes only if the Dual Currency Note Provisions are specified in the applicable Final Terms as being applicable.

- 8.2 *Rate of Interest:* If the rate or amount of interest falls to be determined by reference to an exchange rate, the rate or amount of interest payable shall be determined in the manner specified in the applicable Final Terms.

## 9. **EQUITY-LINKED, COMMODITY, CURRENCY AND CREDIT-LINKED NOTES**

- 9.1 Morgan Stanley, Morgan Stanley Jersey or MSBV may issue Notes:

9.1.1 the payment of principal of which and/or interest on which are linked to the shares of an entity or a basket of shares of entities not affiliated with the Issuer and/or to a single index or indices of shares (respectively, "**Single Share Notes**", "**Share Basket Notes**", "**Single Index Notes**" and "**Index Basket Notes**", and together, "**Equity-Linked Notes**");

9.1.2 the payment of principal of which and/or interest on which are to be determined by reference to one or more commodity prices ("**Commodity Notes**");

9.1.3 the payment of principal of which and/or interest on which are to be determined by reference to one or more currencies as compared to the value of one or more other currencies ("**Currency Notes**"); or

9.1.4 the payment of principal of which and/or interest on which are linked to the credit of one or more specified entities ("**Credit-Linked Notes**");

9.1.5 upon any other terms and conditions,

in each case, in accordance with the Conditions herein which are specified as applicable to Equity-Linked Notes, Commodity Notes, Currency Notes or Credit-Linked Notes, as the case may be, and the detailed terms and conditions set out in the applicable Final Terms.

## 10. **PROVISIONS RELATING TO EQUITY-LINKED NOTES**

This Condition 10 is applicable only in relation to Notes specified in the relevant Final Terms as being Single Share Notes, Share Basket Notes, Single Index Notes or Index Basket Notes.

### 10.1 *Valuation, Market Disruption and Averaging Dates:*

10.1.1 "**Valuation Date**" means each date specified as such in the applicable Final Terms or, if no date is specified, each date specified as an Observation Date or a Determination Date in the applicable Final Terms (or, if such date is not a Scheduled Trading Day, the next following Scheduled Trading Day), subject to the provisions of Condition 10.1.2. If any Valuation Date is a Disrupted Day, then:

- (a) in the case of a Single Index Note or Single Share Note, the Valuation Date shall be the first succeeding Scheduled Trading Day that is not a Disrupted Day, unless each of the eight Scheduled Trading Days immediately following the Scheduled Valuation Date (and, as the case may be, the relevant Observation Date or Determination Date) is a Disrupted Day. In that case, (1) that eighth Scheduled Trading Day shall be deemed to be the Valuation Date, notwithstanding the fact that such day is a Disrupted Day, and (2) the Determination Agent shall determine in its sole and absolute discretion:
  - (i) in respect of a Single Index Note, the level of the Index as of the Determination Time on that eighth Scheduled Trading Day in accordance with the formula for and method of calculating the Index last in effect prior to the occurrence of the first Disrupted Day using the Exchange traded or quoted price as of the Determination Time on that eighth Scheduled Trading Day of each security or other property comprised in the Index (or, if an event giving rise to a Disrupted Day has occurred in respect of the relevant security on that eighth Scheduled Trading Day, its good faith estimate of the value for the relevant security as of the Determination Time on that eighth Scheduled Trading Day); and
  - (ii) in respect of a Single Share Note, its good faith estimate of the value for the Underlying Share as of the Determination Time on that eighth Scheduled Trading Day;
- (b) in the case of an Index Basket Note, the Valuation Date for each Index not affected by the occurrence of a Disrupted Day shall be the Scheduled Valuation Date, and for each Index affected by the occurrence of a Disrupted Day shall be the first succeeding Scheduled Trading Day that is not a Disrupted Day relating to that Index, unless each of the eight Scheduled Trading Days immediately following the Scheduled Valuation Date is a Disrupted Day relating to that Index. In that case, (1) that eighth Scheduled Trading Day shall be deemed to be the Valuation Date for the relevant Index, notwithstanding the fact that such day

is a Disrupted Day, and (2) the Determination Agent shall determine, in its sole and absolute discretion, the level of that Index as of the Determination Time on that eighth Scheduled Trading Day in accordance with the formula for and method of calculating that Index last in effect prior to the occurrence of the first Disrupted Day using the Exchange traded or quoted price as of the Determination Time on that eighth Scheduled Trading Day of each security comprised in that Index (or, if an event giving rise to a Disrupted Day has occurred in respect of the relevant security on that eighth Scheduled Trading Day, its good faith estimate of the value for the relevant security as of the Determination Time on that eighth Scheduled Trading Day); and

- (c) in the case of a Share Basket Note, the Valuation Date for each Underlying Share not affected by the occurrence of a Disrupted Day shall be the Scheduled Valuation Date, and for each Underlying Share affected by the occurrence of a Disrupted Day shall be the first succeeding Scheduled Trading Day that is not a Disrupted Day relating to that Underlying Share, unless each of the eight Scheduled Trading Days immediately following the Scheduled Valuation Date is a Disrupted Day relating to that Underlying Share. In that case, (1) that eighth Scheduled Trading Day shall be deemed to be the Valuation Date for the relevant Underlying Share, notwithstanding the fact that such day is a Disrupted Day, and (2) the Determination Agent shall determine, in its sole and absolute discretion, its good faith estimate of the value for that Underlying Share as of the Determination Time on that eighth Scheduled Trading Day.

10.1.2 For the purposes hereof:

**"Scheduled Valuation Date"** means any original date that, but for the occurrence of an event causing a Disrupted Day, would have been a Valuation Date.

10.1.3 If Averaging Dates are specified in the applicable Final Terms as being applicable, then, notwithstanding any other provisions of these Conditions, the following provisions will apply to the valuation of the relevant Index, Underlying Share, Basket of Indices or Basket of Shares in relation to a Valuation Date:

- (a) **"Averaging Date"** means, in respect of each Valuation Date, each date specified or otherwise determined as provided in the applicable Final Terms (or, if such date is not a Scheduled Trading Day, the next following Scheduled Trading Day).
- (b) For purposes of determining the Settlement Price in relation to a Valuation Date, the Settlement Price will be:
  - (i) in respect of a Single Index Note or a Single Share Note, the arithmetic mean of the Relevant Prices of the Index or the Underlying Shares on each Averaging Date;
  - (ii) in respect of an Index Basket Note, the arithmetic mean of the amounts for the Basket of Indices determined by the Determination Agent in its sole and absolute discretion as provided in the applicable Final Terms as of the relevant Determination Time(s) on each Averaging Date or, if no means for determining the Settlement Price are so provided, the arithmetic mean of the amounts for the Basket calculated on each Averaging Date as the sum of the Relevant Prices of each Index comprised in the Basket

(weighted or adjusted in relation to each Index as provided in the applicable Final Terms); and

- (iii) in respect of a Share Basket Note, the arithmetic mean of the amounts for the Basket of Shares determined by the Determination Agent in its sole and absolute discretion as provided in the applicable Final Terms as of the relevant Determination Time(s) on each Averaging Date or, if no means for determining the Settlement Price is so provided, the arithmetic mean of the amounts for the Basket calculated on each Averaging Date as the sum of the values calculated for the Underlying Shares of each Underlying Share Issuer as the product of (1) the Relevant Price of such Underlying Share and (2) the number of such Underlying Shares comprised in the Basket.
- (c) If an Averaging Date is a Disrupted Day, then if, in relation to "**Averaging Date Disruption**", the consequence specified in the relevant Final Terms is:
- (i) "**Omission**", then such Averaging Date will be deemed not to be a relevant Averaging Date for the purposes of determining the relevant Settlement Price provided that, if through the operation of this provision no Averaging Date would occur with respect to the relevant Valuation Date, then Condition 10.1.1 will apply for purposes of determining the relevant level, price or amount on the final Averaging Date in respect of that Valuation Date as if such final Averaging Date were a Valuation Date that was a Disrupted Day;
  - (ii) "**Postponement**", then Condition 10.1.1 will apply for the purposes of determining the relevant level, price or amount on that Averaging Date as if such Averaging Date were a Valuation Date that was a Disrupted Day irrespective of whether, pursuant to such determination, that deferred Averaging Date would fall on a day that already is or is deemed to be an Averaging Date for the relevant Notes; or
  - (iii) "**Modified Postponement**", then:
    - (1) in the case of a Single Index Note or a Single Share Note, the Averaging Date shall be the first succeeding Valid Date. If the first succeeding Valid Date has not occurred as of the Determination Time on the eighth Scheduled Trading Day immediately following the original date that, but for the occurrence of another Averaging Date or Disrupted Day, would have been the final Averaging Date in relation to the relevant Scheduled Valuation Date, then (A) that eighth Scheduled Trading Day shall be deemed to be the Averaging Date (irrespective of whether that eighth Scheduled Trading Day is already an Averaging Date), and (B) the Determination Agent shall determine, in its sole and absolute discretion, the relevant level or price for that Averaging Date in accordance with (x) in the case of a

Single Index Note, Condition 10.1.1(a)(i) and (y) in the case of a Single Share Note, Condition 10.1.1(a)(ii);

- (2) in the case of an Index Basket Note or a Share Basket Note, the Averaging Date for each Underlying Share or Index not affected by the occurrence of a Disrupted Day shall be the date specified in the applicable Final Terms as an Averaging Date in relation to the relevant Valuation Date, and the Averaging Date for an Underlying Share or Index affected by the occurrence of a Disrupted Day shall be the first succeeding Valid Date in relation to such Underlying Share or Index. If the first succeeding Valid Date in relation to such Underlying Share or Index has not occurred as of the Determination Time on the eighth Scheduled Trading Day immediately following the original date that, but for the occurrence of another Averaging Date or Disrupted Day, would have been the final Averaging Date in relation to the relevant Scheduled Valuation Date, then (A) that eighth Scheduled Trading Day shall be deemed to be the Averaging Date (irrespective of whether that eighth Scheduled Trading Day is already an Averaging Date) in relation to such Underlying Share or Index, and (B) the Determination Agent shall determine, in its sole and absolute discretion, the relevant level or amount for that Averaging Date in accordance with (x) in the case of an Index Basket Note, Condition 10.1.1(b) and (y) in the case of a Share Basket Note, Condition 10.1.1(c); and
- (3) "**Valid Date**" shall mean a Scheduled Trading Day that is not a Disrupted Day and on which another Averaging Date in respect of the relevant Valuation Date does not, or is not deemed to, occur.

- (d) If any Averaging Dates in relation to a Valuation Date occur after that Valuation Date as a result of the occurrence of a Disrupted Day, then (i) the relevant Maturity Date or, as the case may be, the relevant Physical Settlement Date or (ii) the occurrence of an Extraordinary Event or a Potential Adjustment Event shall be determined by reference to the last such Averaging Date as though it were that Valuation Date.

## 10.2 *Adjustments to Indices:*

This Condition 10.2 is applicable only in relation to Notes specified in the relevant Final Terms as being Single Index Notes or Index Basket Notes.

### 10.2.1 *Successor Index:*

If a relevant Index is (a) not calculated and announced by the Index Sponsor, but is calculated and announced by a successor sponsor acceptable to the Determination Agent in its sole and absolute discretion or (b) replaced by a successor index using, in the determination of the Determination Agent (such determination to be at the Determination Agent's sole and absolute discretion), the same or a substantially similar

formula for and method of calculation as used in the calculation of that Index, then in each case that index (the "**Successor Index**") will be deemed to be the Index.

#### 10.2.2 *Index Adjustment Events:*

If (i) on or prior to any Valuation Date, or any Averaging Date, a relevant Index Sponsor announces that it will make a material change in the formula for or the method of calculating that Index or in any other way materially modifies that Index (other than a modification prescribed in that formula or method to maintain that Index in the event of changes in constituent securities and capitalisation and other routine events) (an "**Index Modification**") or permanently cancels the Index and no Successor Index exists (an "**Index Cancellation**") or (ii) on any Valuation Date, or any Averaging Date, the Index Sponsor fails to calculate and announce a relevant Index (an "**Index Disruption**" and together with an Index Modification and an Index Cancellation, each an "**Index Adjustment Event**"), then (A) in the case of an Index Modification or an Index Disruption, the Determination Agent shall determine if such Index Adjustment Event has a material effect on the Notes and, if so, shall calculate in its sole and absolute discretion the relevant Settlement Price using, *in lieu* of a published level for that Index, the level for that Index as at that Valuation Date or, as the case may be, that Averaging Date as determined by the Determination Agent in its sole and absolute discretion in accordance with the formula for and method of calculating that Index last in effect prior to that change, failure or cancellation, but using only those securities that comprised that Index immediately prior to that Index Adjustment Event and (B) in the case of an Index Cancellation, the Issuer may, at any time thereafter and in its sole and absolute discretion, determine that the Notes shall be redeemed as of any later date. If the Issuer so determines that the Notes shall be redeemed, then the Issuer shall give not less than five Business Days' notice to the Noteholders to redeem the Notes and upon redemption the Issuer will pay in respect of each Note an amount which the Determination Agent, in its sole and absolute discretion, determines is equal to the fair value of a Note less the proportion attributable to that Note of the reasonable cost to the Issuer of, or the loss realised by the Issuer on, unwinding any related underlying hedging arrangements, the amount of such cost or loss being as determined by the Determination Agent in its sole and absolute discretion. The Issuer's obligations under the Notes shall be satisfied in full upon payment of such amount. If the Issuer determines that the relevant Notes shall continue, the Determination Agent may make such adjustment as the Determination Agent, in its sole and absolute discretion, considers appropriate, if any, to the formula for the Final Redemption Amount or the Settlement Price set out in the applicable Final Terms and any other variable relevant to the settlement or payment terms of the Notes, which change or adjustment shall be effective on such date as the Determination Agent shall determine.

#### 10.2.3 *Correction of Index Levels:*

If the level of an Index published by the Index Sponsor and which is utilised by the Determination Agent for any calculation or determination (the "**Original Determination**") under the Notes is subsequently corrected and the correction (the "**Corrected Value**") is published by the Index Sponsor by such time as may be specified in the relevant Final Terms (or, if none is so specified, within one Settlement Cycle after the original publication and prior to the Maturity Date), then the Determination Agent will notify the Issuer and the Fiscal Agent of the Corrected Value as soon as reasonably practicable and shall determine the relevant value (the "**Replacement Determination**") using the Corrected Value. If the result of the Replacement Determination is different

from the result of the Original Determination, to the extent that it determines to be necessary and practicable, the Determination Agent may adjust any relevant terms accordingly.

#### 10.2.4 *Currency Inconvertibility*

If the Issuer in good faith determines that a Currency Inconvertibility Event has occurred, it may at any time thereafter, in its sole discretion give notice to the holders stating whether the Issuer's obligations under the Notes will be suspended or terminated (any election to suspend shall not preclude the Issuer at any time thereafter giving notice to redeem the Notes), all as more fully set out in Condition 24 (*Notices*). If the Issuer elects to redeem the Notes the Issuer shall give not less than five Business Days' notice to the Noteholders to redeem the Notes and upon redemption the Issuer will pay in respect of each Note an amount which the Determination Agent, in its sole and absolute discretion, determines is equal to the fair value of a Note, less the cost to the Issuer of, or loss realised by the Issuer as, including any related underlying hedging arrangements, the amount of such cost or loss being as determined by the Determination Agent in its sole and absolute discretion. The Issuer's obligations under the Notes shall be satisfied in full upon payment of such amount. Upon the occurrence of any event that constitutes both a Currency Inconvertibility Event and a Market Disruption Event or an event causing a Disrupted Day, it will be deemed to be a Market Disruption Event or an event causing a Disrupted Day and will not constitute a Currency Inconvertibility Event.

#### 10.3 *Adjustments affecting Underlying Shares:*

This Condition 10.3 is applicable only in relation to Single Share Notes or Share Basket Notes.

##### 10.3.1 *Adjustments for Potential Adjustment Events:*

Following the declaration by the Underlying Issuer of the terms of a Potential Adjustment Event, the Determination Agent will determine whether such Potential Adjustment Event has a diluting or concentrative effect on the theoretical value of the relevant Underlying Shares and, if so, will (i) make such adjustment as it in its sole and absolute discretion considers appropriate, if any, to the formula for the Final Redemption Amount and/or the Settlement Price set out in the relevant Final Terms, the number of Underlying Shares to which each Note relates, the number of Underlying Shares comprised in a Basket of Shares, the amount, the number of or type of shares or other securities which may be delivered in respect of such Notes and/or any other adjustment and, in any case, any other variable relevant to the exercise, settlement, payment or other terms of the relevant Notes as the Determination Agent determines, in its sole and absolute discretion, to be appropriate to account for that diluting or concentrative effect and (ii) determine, in its sole and absolute discretion, the effective date(s) of such adjustment(s).

##### 10.3.2 *Correction of Underlying Share Prices:*

If any price published on the Exchange and which is utilised by the Determination Agent for any calculation or determination (the "**Original Determination**") under the Notes is subsequently corrected and the correction (the "**Corrected Value**") is published by the Exchange by such time as may be specified in the relevant Final Terms (or, if none is so specified, within one Settlement Cycle after the original publication and prior to the Maturity Date), then the Determination Agent will notify the Issuer and the Fiscal Agent of the Corrected Value as soon as reasonably practicable and shall determine the relevant value (the "**Replacement Determination**") using the Corrected Value. If the result of



the Replacement Determination is different from the result of the Original Determination, to the extent that it determines to be necessary and practicable, the Determination Agent may adjust any relevant terms accordingly.

#### 10.4 *Extraordinary Events:*

This Condition 10.4 is applicable only in relation to Notes specified in the relevant Final Terms as being Single Share Notes or Share Basket Notes.

##### 10.4.1 *Merger Event or Tender Offer:*

- (a) Following the occurrence of any Merger Event or Tender Offer, the Issuer will, in its sole and absolute discretion, determine whether the relevant Notes shall continue or shall be redeemed early.
- (b) If the Issuer determines that the relevant Notes shall continue, the Determination Agent may make such adjustment as the Determination Agent, in its sole and absolute discretion, considers appropriate, if any, to the formula for the Final Redemption Amount and/or the Settlement Price set out in the applicable Final Terms, the number of Underlying Shares to which each Note relates, the number of Underlying Shares comprised in a Basket of Shares, the amount, the number of or type of shares or other securities which may be delivered under such Notes and, in any case, any other variable relevant to the exercise, settlement, or payment terms of the relevant Notes and/or any other adjustment (including without limitation, in relation to Share Basket Notes, the cancellation of terms applicable in respect of Underlying Shares affected by the relevant Merger Event or Tender Offer) which adjustment shall be effective on such date as the Determination Agent shall determine.
- (c) If the Issuer determines that the relevant Notes shall be redeemed early, then the Issuer shall give not less than five Business Days' notice to the Noteholders to redeem the Notes and the Issuer's obligations under the Notes shall be satisfied in full upon payment of the Merger Event Settlement Amount (as defined below) (in the case of a Merger Event) or Tender Offer Settlement Amount (in the case of a Tender Offer).
- (d) For the purposes hereof:

**"Merger Event"** means, in respect of any relevant Underlying Shares, as determined by the Determination Agent, acting in a commercially reasonable manner, any: (i) reclassification or change of such Underlying Shares that results in a transfer of or an irrevocable commitment to transfer all of such Underlying Shares outstanding to another entity or person, (ii) consolidation, amalgamation, merger or binding share exchange of the Underlying Issuer with or into another entity or person (other than a consolidation, amalgamation, merger or binding share exchange in which such Underlying Issuer is the continuing entity and which does not result in a reclassification or change of all such Underlying Shares outstanding), (iii) takeover offer, tender offer, exchange offer, solicitation, proposal or other event by any entity or person to purchase or otherwise obtain 100% of the outstanding Underlying Shares of the Underlying Issuer that results in a transfer of or an irrevocable commitment to transfer all such Underlying Shares (other than such Underlying Shares owned or controlled by such other entity or person), or (iv) consolidation, amalgamation, merger or binding share

exchange of the Underlying Issuer or its subsidiaries with or into another entity in which the Underlying Issuer is the continuing entity and which does not result in a reclassification or change of all such Underlying Shares outstanding but results in the outstanding Underlying Shares (other than Underlying Shares owned or controlled by such other entity) immediately prior to such event collectively representing less than 50% of the outstanding Underlying Shares immediately following such event (a "**Reverse Merger**"), in each case if the Merger Date is on or before, (A) in respect of Physical Settlement Notes, the later to occur of the Maturity Date and the Physical Settlement Date or, (B) in any other case, the final Valuation Date.

**"Merger Event Settlement Amount"** means in respect of each Note, an amount equal to the fair value of such Note, on such day as is selected by the Determination Agent in its sole and absolute discretion, less the proportion attributable to that Note of the reasonable cost to the Issuer of, or the loss realised by the Issuer on, unwinding any related hedging arrangements, all as calculated by the Determination Agent in its sole and absolute discretion.

**"Tender Offer"** means, in respect of any Underlying Shares, as determined by the Determination Agent, acting in a commercially reasonable manner, a takeover offer, tender offer, exchange offer, solicitation, proposal or other event by any entity or person that results in such entity or person purchasing, or otherwise obtaining or having the right to obtain, by conversion or other means, greater than 10% and less than 100% of the outstanding voting shares of the Underlying Issuer, as determined by the Determination Agent, based upon the making of filings with governmental or self-regulatory agencies or such other information as the Determination Agent deems relevant.

**"Tender Offer Date"** means, in respect of a Tender Offer, the date on which voting shares in the amount of the applicable percentage threshold are actually purchased or otherwise obtained, as determined by the Determination Agent in its sole and absolute discretion.

**"Tender Offer Settlement Amount"** means in respect of each Note, an amount equal to the fair value of such Note, on such day as is selected by the Determination Agent in its sole and absolute discretion, less the proportion attributable to that Note of the reasonable cost to the Issuer of unwinding, or the loss realised by the Issuer on, any related hedging arrangements, all as calculated by the Determination Agent in its sole and absolute discretion.

#### 10.4.2 *Nationalisation, Insolvency and Delisting:*

- (a) If in the determination of the Determination Agent, acting in a commercially reasonable manner:
  - (A) all the Underlying Shares or all or substantially all the assets of an Underlying Issuer are nationalised, expropriated or are otherwise required to be transferred to any governmental agency, authority, entity or instrumentality thereof ("**Nationalisation**"); or
  - (B) by reason of the voluntary or involuntary liquidation, bankruptcy, insolvency, dissolution or winding-up of or any analogous proceeding affecting an Underlying Issuer, (1) all the Underlying Shares of that Underlying Issuer are required to be transferred to a

trustee, liquidator or other similar official or (2) holders of the Underlying Shares of that Underlying Issuer become legally prohibited from transferring them ("**Insolvency**") or

- (C) the Exchange announces that pursuant to the rules of such Exchange, the Underlying Shares cease (or will cease) to be listed, traded or publicly quoted on the Exchange for any reason (other than a Merger Event or Tender Offer) and are not immediately re-listed, re-traded or re-quoted on an exchange or quotation system located in the same country as the Exchange (or, where the Exchange is within the European Union, in any member state of the European Union) ("**Delisting**"),

then the Issuer will, in its sole and absolute discretion, determine whether or not the Notes shall continue.

- (b) If the Issuer determines that the relevant Notes shall continue, the Determination Agent may make such adjustment as the Determination Agent, in its sole and absolute discretion, considers appropriate, if any, to the formula for the Final Redemption Amount and/or the Settlement Price set out in the applicable Final Terms, the number of Underlying Shares to which each Note relates, the number of Underlying Shares comprised in a Basket of Shares, the amount, the number of or type of shares or other securities which may be delivered under such Notes and, in any case, any other variable relevant to the settlement or payment terms of the relevant Notes and/or any other adjustment (including without limitation, in relation to Share Basket Notes, the cancellation of terms applicable in respect of Underlying Shares affected by the relevant Extraordinary Event) which change or adjustment shall be effective on such date as the Determination Agent shall determine.
- (c) If the Issuer determines that the relevant Notes shall be redeemed early, then the Issuer shall give not less than five Business Days' notice to redeem the Notes. The Issuer's obligations under the Notes shall be satisfied in full upon payment of, in respect of each Note, an amount equal to the fair value of such Note, on such day as is selected by the Determination Agent in its sole and absolute discretion, less the proportion attributable to that Note of the reasonable cost to the Issuer of unwinding, or the loss realised by the Issuer on, any related hedging arrangements, all as calculated by the Determination Agent in its sole and absolute discretion.

#### 10.5 *Additional Disruption Events*

- (a) Following the occurrence of an Additional Disruption Event, the Issuer will, in its sole and absolute discretion, determine whether or not the relevant Notes shall continue or be redeemed early.
- (b) If the Issuer determines that the relevant Notes shall continue, the Determination Agent may make such adjustment as the Determination Agent, in its sole and absolute discretion, considers appropriate, if any, to the formula for the Final Redemption Amount and/or the Settlement Price set out in the relevant Final Terms, the number of Underlying Shares to which each Note relates, the number of Underlying Shares comprised in a Basket, the amount, the number of or type of shares or other securities which may be delivered under such Notes and, in any case, any other variable relevant to the redemption, settlement, or payment terms of the relevant Notes and/or any other

adjustment (including without limitation, in relation to Share Basket Notes or Index Basket Notes, the cancellation of terms applicable in respect of any Underlying Shares or Index, as the case may be, affected by the relevant Additional Disruption Event) which change or adjustment shall be effective on such date as the Determination Agent shall determine.

- (c) If the Issuer determines that the relevant Notes shall be redeemed early, then the Issuer shall give not less than five Business Days' notice to redeem the Notes and the Issuer's obligations under the Notes shall be satisfied in full upon payment in respect of each Note of an amount which the Determination Agent, in its sole and absolute discretion, determines is equal to the fair value of a Note less the proportion attributable to that Note of the reasonable cost to the Issuer of, or the loss realised by the Issuer on, unwinding any related underlying hedging arrangements, the amount of such cost or loss being as determined by the Determination Agent in its sole and absolute discretion.
- (d) The Issuer shall as soon as reasonably practicable under the circumstances notify the Fiscal Agent and the Determination Agent of the occurrence of an Additional Disruption Event.
- (e) For the purposes hereof:

"**Additional Disruption Event**" means with respect to any Series of Notes (unless otherwise specified in the applicable Final Terms) a Change in Law, Hedging Disruption, Increased Cost of Hedging and Loss of Stock Borrow, and any further event or events as may be specified in the applicable Final Terms as an Additional Disruption Event with respect to such Notes.

#### 10.6 *Definitions applicable to Equity-Linked Notes*

In relation to Equity-Linked Notes, the following expressions have the meanings set out below:

"**Basket**" means in relation to any Share Basket Notes, the Underlying Shares specified in the applicable Final Terms as comprising the Basket, and in relation to Index Basket Notes, the Indices specified in the applicable Final Terms as comprising the Basket, in each case in the relative proportions specified in such Final Terms;

"**Basket of Indices**" means, in relation to a particular Series, a basket comprising the Indices specified in the applicable Final Terms in the relative proportions specified in such Final Terms;

"**Basket of Shares**" means, in relation to a particular Series, a basket comprising Underlying Shares of each Underlying Issuer specified in the applicable Final Terms in the relative proportion or number of Underlying Shares of each Underlying Issuer specified in such Final Terms;

"**Change in Law**" means that, on or after the Trade Date (A) due to the adoption of or any change in any applicable law or regulation (including, without limitation, any tax law), or (B) due to the promulgation of or any change in the interpretation by any court, tribunal or regulatory authority with competent jurisdiction of any applicable law or regulation (including any action taken by a taxing authority), the Issuer determines that (x), in the case of Single Share Notes or Basket of Shares Notes, it has become illegal to hold, acquire or dispose of any relevant Underlying Shares, or (y) it will incur a materially increased cost in performing its obligations with respect to the Notes (including, without limitation, due to any increase in tax liability, decrease in tax benefit or other adverse effect on its tax position);

"**Component**" means in relation to an Index, any security which comprises such Index;

**"Currency Inconvertibility Event"** means it has become impracticable, illegal or impossible: (i) for the Determination Agent to determine a rate at which any Local Currency (defined below) can be lawfully exchanged for U.S. dollars; or (ii) to convert the currency in which any of the securities which comprise the Index is denominated (a **"Local Currency"**) into U.S. dollars; or (iii) to exchange or repatriate any funds outside of any jurisdiction in which any of the securities which comprise the Index is issued due to the adoption of or any change in any applicable law, regulation, directive or decree of any Governmental Authority or otherwise; or (iv) for the Issuer or any of its affiliates to hold, purchase, sell or otherwise deal in any Notes or any other property in order for the Issuer or any of its affiliates to perform, or for the purposes of the Issuer or any affiliate of the Issuer performing its obligations in respect of any Notes or in respect of any related hedging arrangements. For the purposes hereof, **"Governmental Authority"** means any governmental, administrative, legislative or judicial authority or power;

**"Determination Time"** means the time specified as such in the applicable Final Terms, or if no such time is specified, (a) save with respect to a Multi-exchange Index, the Scheduled Closing Time on the relevant Exchange in relation to each Index or Underlying Share to be valued. If the relevant Exchange closes prior to its Scheduled Closing Time and the specified Determination Time is after the actual closing time for its regular trading session, then the Determination Time shall be such actual closing time; and (b) with respect to any Multi-exchange Index, (i) for the purposes of determining whether a Market Disruption Event has occurred: (x) in respect of any Component, the Scheduled Closing Time on the Exchange in respect of such Component and (y) in respect of any option contracts or futures contracts on the Index, the close of trading on the Related Exchange; and (ii) in all other circumstances, the time at which the official closing level of the Index is calculated and published by the Index Sponsor;

**"Disrupted Day"** means (a) except with respect to a Multi-exchange Index, any Scheduled Trading Day on which a relevant Exchange or any Related Exchange fails to open for trading during its regular trading session or on which a Market Disruption Event has occurred, and (b) with respect to any Multi-exchange Index, any Scheduled Trading Day on which (i) the Index Sponsor fails to publish the level of the Index; (ii) the Related Exchange fails to open for trading during its regular trading session or (iii) a Market Disruption Event has occurred;

**"Early Closure"** means (a) except with respect to a Multi-exchange Index, the closure on any Exchange Business Day of the relevant Exchange (or in the case of a Single Index Note or Index Basket Note, any relevant Exchange(s) relating to securities that comprise 20 percent or more of the level of the relevant Index) or any Related Exchange(s) prior to its Scheduled Closing Time unless such earlier closing time is announced by such Exchange(s) or Related Exchange(s) at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on such Exchange(s) or Related Exchange(s) on such Exchange Business Day and (ii) the submission deadline for orders to be entered into the Exchange or Related Exchange system for execution at the Determination Time on such Exchange Business Day and (b) with respect to any Multi-exchange Index, the closure on any Exchange Business Day of the Exchange in respect of any Component or the Related Exchange prior to its Scheduled Closing Time unless such earlier closing is announced by such Exchange or Related Exchange (as the case may be) at least one hour prior to the earlier of: (i) the actual closing time for the regular trading session on such Exchange or Related Exchange (as the case may be) on such Exchange Business Day; and (ii) the submission deadline for orders to be entered into such Exchange or Related Exchange system for execution at the relevant Determination Time on such Exchange Business Day;

**"Exchange"** means:

- (a) (i) in respect of an Index relating to Single Index Notes or Index Basket Notes other than a Multi-exchange Index, each exchange or quotation system specified as such for

such Index in the applicable Final Terms or, if none is specified, the principal exchange or quotation system for trading in such Index, as determined by the Determination Agent, any successor to such exchange or quotation system or any substitute exchange or quotation system to which trading in the shares underlying such Index has temporarily relocated, provided that the Determination Agent has determined that there is comparable liquidity relative to the shares underlying such Index on such temporary substitute exchange or quotation system as on the original Exchange, and (ii) with respect to any Multi-exchange Index, and in respect of each Component, the principal stock exchange on which such Component is principally traded, as determined by the Determination Agent; and

- (b) in respect of an Underlying Share relating to Single Share Notes or Share Basket Notes, each exchange or quotation system specified as such for such Underlying Share in the applicable Final Terms or, if none is specified, the principal exchange or quotation system for trading in such Underlying Share, as determined by the Determination Agent, any successor to such Exchange or quotation system or any substitute exchange or quotation system to which trading in the Underlying Share has temporarily relocated, provided that the Determination Agent has determined that there is comparable liquidity relative to such Underlying Share on such temporary substitute exchange or quotation system as on the original Exchange.

**"Exchange Business Day"** means (a) except with respect to a Multi-exchange Index, any Scheduled Trading Day on which each Exchange and Related Exchange are open for trading during their respective regular trading sessions, notwithstanding any such Exchange or Related Exchange closing prior to its Scheduled Closing Time and (b) with respect to any Multi-exchange Index, any Scheduled Trading Day on which (i) the Index Sponsor publishes the level of the Index and (ii) the Related Exchange is open for trading during its regular trading session, notwithstanding any Exchange or the Related Exchange closing prior to its Scheduled Closing Time;

**"Exchange Disruption"** means (a) except with respect to a Multi-exchange Index, any event (other than an Early Closure) that disrupts or impairs (as determined by the Determination Agent) the ability of market participants in general (i) to effect transactions in, or obtain market values for, the Underlying Shares on the Exchange (or in the case of Single Index Notes or Index Basket Notes, on any relevant Exchange(s) relating to securities that comprise 20 percent or more of the level of the relevant Index), or (ii) to effect transactions in, or obtain market values for, futures or options contracts relating to the Underlying Shares or the relevant Index on any relevant Related Exchange and (b) with respect to any Multi-exchange Index, any event (other than an Early Closure) that disrupts or impairs (as determined by the Determination Agent) the ability of market participants in general to effect transactions in, or obtain market values for, (i) any Component on the Exchange in respect of such Component; or (ii) futures or options contracts relating to the Index on the Related Exchange;

**"Extraordinary Dividend"** means the dividend per Underlying Share, or portion thereof, to be characterised as an Extraordinary Dividend as determined by the Determination Agent.

**"Extraordinary Event"** means a Merger Event, Tender Offer, Nationalisation, Insolvency or Delisting.

**"Hedging Disruption"** means that the Issuer is unable, after using commercially reasonable efforts, to (A) acquire, establish, re-establish, substitute, maintain, unwind or dispose of any transaction(s) or asset(s) it deems necessary to hedge the risk of entering into and performing its obligations under the Notes, or (B) realise, recover or remit the proceeds of any such transactions or asset(s);

**"Increased Cost of Hedging"** means that the Issuer would incur a materially increased (as compared with circumstances existing on the Trade Date) amount of tax, duty, expense or fee (other than brokerage commissions) to (A) acquire, establish, re-establish, substitute, maintain, unwind or dispose of any transaction(s) or asset(s) it deems necessary to hedge the risk of entering into and performing its obligations with respect to the Notes or (B) realise, recover or remit the proceeds of any such transaction(s) or asset(s) provided that any such materially increased amount that is incurred solely due to the deterioration of the creditworthiness of the Issuer shall not be deemed an Increased Cost of Hedging;

**"Index"** means any index specified as such in the applicable Final Terms, subject to Condition 10.2 (*Adjustments to Indices*);

**"Index Sponsor"** means, in respect of an Index, the corporation or other entity that (a) is responsible for setting and reviewing the rules and procedures and methods of calculation and adjustments, if any, related to the relevant Index and (b) announces (directly or through an agent) the level of the relevant Index on a regular basis during each Scheduled Trading Day;

**"Loss of Stock Borrow"** means that the Issuer is unable, after using commercially reasonable efforts, to borrow (or maintain a borrowing of) the Underlying Shares with respect to the Notes in an amount which the Issuer deems necessary to hedge the risk of entering into and performing its obligations with respect to the Notes (not to exceed the number of shares underlying the Notes) at a rate determined by the Issuer;

**"Market Disruption Event"** means (a) in respect of an Underlying Share or an Index other than a Multi-exchange Index, the occurrence or existence of (i) a Trading Disruption, (ii) an Exchange Disruption, which in either case the Determination Agent determines is material, at any time during the one-hour period that ends at the relevant Determination Time, or (iii) an Early Closure. For the purpose of determining whether a Market Disruption Event exists in respect of an Index at any time, if a Market Disruption Event occurs in respect of a security included in the Index at any time, then the relevant percentage contribution of that security to the level of the Index shall be based on a comparison of (x) the portion of the level of the Index attributable to that security and (y) the overall level of the Index, in each case immediately before the Market Disruption Event occurred; and (b) with respect to any Multi-exchange Index either (i)(A) the occurrence or existence, in respect of any Component, of (1) a Trading Disruption, (2) an Exchange Disruption, which in either case the Determination Agent determines is material, at any time during the one hour period that ends at the relevant Determination Time in respect of the Exchange on which such Component is principally traded, OR (3) an Early Closure; AND (B) the aggregate of all Components in respect of which a Trading Disruption, an Exchange Disruption or an Early Closure occurs or exists comprises 20 per cent. or more of the level of the Index; OR (ii) the occurrence or existence, in respect of futures or options contracts relating to the Index, of: (A) a Trading Disruption, (B) an Exchange Disruption, which in either case the Determination Agent determines is material, at any time during the one hour period that ends at the relevant Determination Time in respect of the Related Exchange; or (c) an Early Closure;

For the purposes of determining whether a Market Disruption Event exists in respect of a Component at any time, if a Market Disruption Event occurs in respect of such Component at that time, then the relevant percentage contribution of that Component to the level of the Index shall be based on a comparison of (x) the portion of the level of the Index attributable to that Component to (y) the overall level of the Index, in each case using the official opening weightings as published by the Index Sponsor as part of the market "opening data";

**"Multi-exchange Index"** means any Index specified as such in the relevant Final Terms;

**"Potential Adjustment Event"** means, in respect of Single Share Notes or Share Basket Notes:

- (i) a subdivision, consolidation or reclassification of an Underlying Share (unless resulting in a Merger Event), or a free distribution or dividend of Underlying Shares to existing holders by way of bonus, capitalisation or similar issue;
- (ii) a distribution, issue or dividend to existing holders of relevant Underlying Shares of (A) such Underlying Shares, or (B) other share capital or securities granting the right to payment of dividends and/or the proceeds of liquidation of the Underlying Issuer equally or proportionately with such payments to holders of such an Underlying Shares, or (C) share capital or other securities of another issuer acquired or owned (directly or indirectly) by the Underlying Issuer as a result of a spin-off or other similar transaction, or (D) any other type of securities, rights or warrants or other assets, in any case for payment (cash or other consideration) at less than the prevailing market price as determined by the Determination Agent;
- (iii) an Extraordinary Dividend;
- (iv) a call by the Underlying Issuer in respect of relevant Underlying Shares that are not fully paid;
- (v) a repurchase by an Underlying Issuer or any of its subsidiaries of Underlying Shares, whether out of profits or capital and whether the consideration for such repurchase is cash, securities or otherwise;
- (vi) in respect of an Underlying Issuer, an event that results in any shareholder rights being distributed or becoming separated from shares of common stock or other shares of the capital stock of the Underlying Issuer pursuant to a shareholder rights plan or arrangement directed against hostile takeovers that provides, upon the occurrence of certain events, for a distribution of preferred stock, warrants, debt instruments or stock rights at a price below their market value, as determined by the Determination Agent, provided that any adjustment effected as a result of such an event shall be readjusted upon any redemption of such rights; or
- (vii) any other event that may have a diluting or concentrative effect on the theoretical value of the relevant Underlying Shares.

**"Related Exchange"**, in respect of an Index relating to Single Index Notes or Index Basket Notes or an Underlying Share relating to Single Share Notes or Share Basket Notes, means the Exchange specified as the Relevant Exchange in the applicable Final Terms, any successor to such exchange or quotation system or any substitute exchange or quotation system to which trading in futures and options contracts relating to such Index or Underlying Shares has temporarily relocated (provided that the Determination Agent has determined that there is comparable liquidity relative to the futures or options contracts relating to such Index or Underlying Shares on such temporary substitute exchange or quotation system as on the original Related Exchange) or, if none is specified, each exchange or quotation system where trading has a material effect (as determined by the Determination Agent) on the overall market for futures or options contracts relating to such Index or Underlying Shares, as the case may be;

**"Relevant Price"** on any day means:

- (i) in respect of an Underlying Share to which a Single Share Note or a Share Basket Note relates, the price per Underlying Share determined by the Determination Agent in the manner provided in the applicable Final Terms as of the Determination Time on the



relevant day, or, if no means for determining the Relevant Price are so provided: (a) in respect of any Underlying Share for which the Exchange is an auction or "open outcry" exchange that has a price as of the Determination Time at which any trade can be submitted for execution, the Relevant Price shall be the price per Underlying Share as of the Determination Time on the relevant day, as reported in the official real-time price dissemination mechanism for such Exchange; and (b) in respect of any Underlying Share for which the Exchange is a dealer exchange or dealer quotation system, the Relevant Price shall be the mid-point of the highest bid and lowest ask prices quoted as of the Determination Time on the relevant day (or the last such prices quoted immediately before the Determination Time) without regard to quotations that "lock" or "cross" the dealer exchange or dealer quotation system; and

- (ii) in respect of an Index to which a Single Index Note or an Index Basket Note relates, the level of such Index determined by the Determination Agent as provided in the relevant Final Terms as of the Determination Time on the relevant day or, if no method for determining the Relevant Price is so provided, the level of the Index as of the Determination Time on the relevant day;

**"Scheduled Closing Time"** means in respect of an Exchange or Related Exchange and a Scheduled Trading Day, the scheduled weekday closing time of such Exchange or Related Exchange on such Scheduled Trading Day, without regard to after-hours or any other trading outside of regular trading session hours;

**"Scheduled Trading Day"** means (a) except with respect to a Multi-exchange Index, any day on which each Exchange and each Related Exchange are scheduled to be open for trading for their respective regular trading session, and (b) with respect to any Multi-exchange Index, any day on which (i) the Index Sponsor is scheduled to publish the level of the Index and (ii) the Related Exchange is scheduled to be open for trading for its regular trading session;

**"Settlement Cycle"** means, in respect of an Underlying Share or Index, the period of Settlement Cycle Days following a trade in such Underlying Share or the securities underlying such Index, as the case may be, on the Exchange in which settlement will customarily occur according to the rules of such exchange (or, in respect of any Multi-Exchange Index, the longest such period) and for this purpose **"Settlement Cycle Day"** means, in relation to a clearing system any day on which such clearing system is (or but for the occurrence of a Settlement Disruption Event would have been) open for acceptance and executions of settlement instructions;

**"Settlement Price"** means in respect of a Single Share Note, a Share Basket Note, an Index Note or an Index Basket Note, the price, level or amount as determined by the Determination Agent, in its sole and absolute discretion, in accordance with the relevant Final Terms;

**"Trading Disruption"** means (a) except with respect to a Multi-exchange Index, any suspension of or limitation imposed on trading by the Exchange or Related Exchange or otherwise and whether by reason of movements in price exceeding limits permitted by the Exchange, Related Exchange or otherwise (i) relating to the Underlying Share on the Exchange, or, in the case of a Single Index Note or Index Basket Note, on any relevant Exchange(s) relating to securities that comprise 20 per cent or more of the level of the relevant Index or (ii) in futures or options contracts relating to the Underlying Share or the relevant Index or Indices on any relevant Related Exchange, and (b) with respect to any Multi-exchange Index, any suspension of or limitation imposed on trading by the Exchange or Related Exchange or otherwise and whether by reason of movements in price exceeding limits permitted by the Exchange or Related Exchange or otherwise (i) relating to any Component on the Exchange in respect of such Component; or (ii) in futures or options contracts relating to the Index on the Related Exchange;

**"Underlying Issuer"** means the entity that is the issuer of the Underlying Share specified in the applicable Final Terms; and

**"Underlying Share"** means, in relation to a particular Series of Notes, a share specified as such in the applicable Final Terms, or, in the case of a Share Basket Note, a share forming part of a basket of shares to which such Note relates.

## 11 PROVISIONS RELATING TO COMMODITY NOTES

This Condition 11 is applicable only in relation to Notes specified in the relevant Final Terms as being Commodity Notes.

11.1 *Corrections to published prices:* For the purposes of determining the Relevant Price for any Pricing Date, if applicable, as specified in the relevant Final Terms for the purposes of calculating the Final Redemption Amount or any other amount in respect of a Commodity Note, if the price published or announced on a given day and used or to be used by the Determination Agent to determine such Relevant Price is subsequently corrected and the correction is published or announced by the person responsible for that publication or announcement by such time as may be specified in the relevant Final Terms (or, if none is so specified, within thirty calendar days after the original publication or announcement) and in any event prior to the Maturity Date for the relevant Notes the Determination Agent shall determine (in its sole and absolute discretion) the adjustment to the Relevant Price so calculated and will adjust the terms of the relevant Notes to account for such correction to the extent that it determines to be necessary and practicable.

### 11.2 *Commodity Disruption Events:*

11.2.1 If so specified in the Final Terms relating to any Series of Commodity Notes, the following shall constitute "Commodity Disruption Events" for the purposes of such Series:

- (a) **"Price Source Disruption"**, which means (i) the failure of the Price Source to announce or publish the Specified Price (or the information necessary for determining the Specified Price) for the relevant Commodity Reference Price, (ii) the temporary or permanent discontinuance or unavailability of the Price Source, (iii) if the Commodity Reference Price is "Commodity-Reference Dealers," the failure to obtain at least three quotations from the relevant Reference Dealers or (iv) if Price Materiality Percentage is specified in the applicable Final Terms, the Specified Price for the relevant Commodity Reference Price differs from the Specified Price determined in accordance with the Commodity Reference Price "Commodity-Reference Dealers" by such Price Materiality Percentage;
- (b) **"Trading Disruption"**, which means the material suspension of, or the material limitation imposed on, trading in the Futures Contract or the Commodity on the Exchange or in any additional futures contract, options contract or commodity on any Exchange as specified in the applicable Final Terms. The determination of whether a suspension of or limitation on trading is material shall be made by the Determination Agent in its sole and absolute discretion;
- (c) **"Disappearance of Commodity Reference Price"**, which means (i) the permanent discontinuation of trading in the relevant Futures Contract on the relevant Exchange or (ii) the disappearance of, or of trading in, the relevant Commodity or (iii) the disappearance or permanent discontinuance or

unavailability of a Commodity Reference Price, notwithstanding the availability of the related Price Source or the status of trading in the relevant Futures Contract or the relevant Commodity;

- (d) **"Material Change in Formula"** means the occurrence since the Trade Date of a material change in the formula for or method of calculating the relevant Commodity Reference Price;
- (e) **"Material Change in Content"**, which means the occurrence since the Trade Date of a material change in the content, composition or constitution of the relevant Commodity or relevant Futures Contract;
- (f) **"Tax Disruption"**, which means the imposition of, change in or removal of an excise, severance, sales, use, value-added, transfer, stamp, documentary, recording or similar tax on, or measured by reference to, the relevant Commodity (other than a tax on, or measured by reference to, overall gross or net income) by any government or taxation authority after the Trade Date, if the direct effect of such imposition, change or removal is to raise or lower the Relevant Price on the day that would otherwise be a Pricing Date from what it would have been without that imposition, change or removal;
- (g) **"Trading Limitation"** which means the material limitation imposed on trading in the Futures Contract or Commodity on the Exchange or in any additional futures contract, options contract or commodity on any exchange or principal trading market as specified in the applicable Final Terms; and
- (h) any other (if any) Commodity Disruption Event specified in the relevant Final Terms.

11.2.2 If the applicable Final Terms for a Series of Commodity Notes specifies that any Commodity Disruption Event shall be applicable to such Series, then, where the Determination Agent determines, acting in a commercially reasonable manner, that such Commodity Disruption Event has occurred and is continuing in respect of such Series on the Pricing Date in respect of such Series (or, if different, the day on which prices for that Pricing Date would, in the ordinary course, be published or announced by the Price Source), or on any other day as may be specified for this purpose in the relevant Final Terms, then the Relevant Price will be determined in accordance with the terms of the Commodity Disruption Fallback applicable pursuant to Condition 11.3 (*Commodity Disruption Fallbacks*).

### 11.3 *Commodity Disruption Fallbacks:*

Where one or more Commodity Disruption Event occurs or exists, then, unless the applicable Final Terms specifies that any other Commodity Disruption Fallback shall apply in respect of any such Commodity Disruption Event, "Determination Agent Determination" shall apply.

**"Determination Agent Determination"** means that the Determination Agent will determine, in its sole and absolute discretion, the Relevant Price (or a method for determining the Relevant Price), taking into consideration the latest available quotation for the relevant Commodity Reference Price and any other information that it deems relevant.

#### 11.4 *Common Pricing:*

With respect to Notes relating to a basket of Commodities, if "Common Pricing" has been selected in the applicable Final Terms as:

- (i) "Applicable", then no date will be a Pricing Date unless such date is a day on which all referenced Commodity Reference Prices (for which such date would otherwise be a Pricing Date) are scheduled to be published or announced, as determined as of the time of issue of the Notes.
- (ii) "Inapplicable", then if the Determination Agent determines that a Commodity Disruption Event has occurred or exists on the Pricing Date in respect of any Commodity in the basket (the "**Affected Commodity**"), the Relevant Price of each Commodity within the basket which is not affected by the occurrence of a Commodity Disruption Event shall be determined on its scheduled Pricing Date and the Relevant Price for the Affected Commodity shall be determined in accordance with the first applicable Commodity Disruption Fallback that provides a Commodity Reference Price.

#### 11.5 *Commodity Index Disruption Events:*

11.5.1 The following shall constitute "**Commodity Index Disruption Events**" for the purposes of any Series of Notes with respect to a Commodity Index:

- (a) a temporary or permanent failure by the applicable exchange or other price source to announce or publish the final settlement price for the relevant Commodity Index; or
- (b) the occurrence in respect of any Component of the relevant Commodity Index of a Commodity Disruption Event (as defined in Condition 11.2.1).

11.5.2 Where the Determination Agent determines, acting in a commercially reasonable manner, that a Commodity Index Disruption Event has occurred and is continuing in respect of a Series on the Pricing Date in respect of such Series (or, if different, the day on which prices for that Pricing Date would, in the ordinary course, be published or announced by the Price Source), or on any other day as may be specified for this purpose in the applicable Final Terms, then (unless Condition 11.5.3 (*Physical Hedging Fallback*) applies) the following provisions shall apply:

- (a) with respect to each Component which is not affected by the Commodity Index Disruption Event, the Relevant Price will be determined by the Determination Agent based on the closing prices of each such Component on the applicable Pricing Date;
- (b) with respect to each Component which is affected by the Commodity Index Disruption Event, the Relevant Price will be determined by the Determination Agent (in the case of any Dow Jones-AIG Commodity Index) as set out in the DJ-AIGCI Manual or (in the case of any GS Commodity Index) as set out in the GSCI Manual, and in respect of any other Commodity Index as set out in the applicable Final Terms, in each case based on the closing prices of each such Component on the first day following the applicable Pricing Date on which no Commodity Index Disruption Event occurs with respect to such Component;

- (c) subject to (d) below, the Determination Agent shall determine the Relevant Price by reference to the closing prices determined in (a) and (b) above using the then-current method for calculating the relevant Commodity Index; and
- (d) where a Commodity Index Disruption Event with respect to one or more Components continues to exist (measured from and including the first day following the applicable determination date) for five consecutive Trading Days, the Determination Agent shall determine the Relevant Price acting in good faith and in a commercially reasonable manner. In calculating the Relevant Price as set out in this paragraph, the Determination Agent shall use the formula for calculating the relevant Commodity Index last in effect prior to the Commodity Index Disruption Event. For the purposes of this paragraph (d), "**Trading Day**" shall mean a day when the exchanges for all Components included in the relevant Commodity Index are scheduled to be open for trading.

11.5.3 *Physical Hedging Fallback.* Where the Determination Agent determines that a Commodity Index Disruption Event has occurred and is continuing in respect of a Series on the Pricing Date in respect of such Series and "Physical Hedging Fallback" is specified as applicable in the relevant Final Terms, then the following provisions shall apply;

- (a) with respect to each Component included in the Commodity Index which is not affected by the Commodity Index Disruption Event, the Relevant Price will be based on the closing prices of each such Component on the applicable determination date;
- (b) with respect to each Component included in the Commodity Index which is affected by the Commodity Index Disruption Event, the Relevant Price will be based on the closing price of each such Component on the first day following the applicable determination date on which no Commodity Index Disruption Event occurs with respect to such Component;
- (c) subject to (d) below, the Determination Agent shall determine the Relevant Price by reference to the closing prices determined in (a) and (b) above using the then-current method for calculating the Relevant Price; and
- (d) where a Commodity Index Disruption Event with respect to one or more Components included in the Commodity Index continues to exist (measured from and including the first day following the applicable determination date) for five consecutive Trading Days, the Determination Agent shall determine the Relevant Price in good faith and in a commercially reasonable manner. For the purposes of this paragraph (d), "**Trading Day**" shall mean a day when the exchanges for all Components included in the relevant Commodity Index are scheduled to be open for trading with respect to each Component included in the Commodity Index which is not affected by the Commodity Index Disruption Event, the Relevant Price will be based on the closing prices of each such Component on the applicable determination date.

#### 11.6 *Adjustments to Commodity Index:*

- 11.6.1 If a Commodity Index with respect to a Commodity Reference Price is permanently cancelled or is not calculated and announced by the sponsor of such Commodity Index or any of its affiliates (together the "**Sponsor**") but (i) is calculated and announced by a successor sponsor (the "**Successor Sponsor**") acceptable to the Determination Agent, or (ii) replaced by a successor index (the "**Successor Index**") using, in the determination of the Determination Agent, the same or a substantially similar formula for and method of calculation as used in the calculation of such Commodity Index, then the Commodity Reference Price will be determined by reference to the Index so calculated and announced by that Successor Sponsor or that Successor Index, as the case may be.
- 11.6.2 If, for a Commodity Index with respect to a Commodity Reference Price, on or prior to the Maturity Date or Early Redemption Date, (i) the Sponsor makes a material change in the formula for or the method of calculating such Commodity Index or in any other way materially modifies such Commodity Index (other than a modification prescribed in that formula or method to maintain the Commodity Index in the event of changes in constituent commodities and weightings and other routine events), or (ii) the Sponsor permanently cancels the Commodity Index or (iii) the Sponsor fails to calculate and announce the Commodity Index for a continuous period of three Trading Days and the Determination Agent determines that there is no Successor Sponsor or Successor Index, then the Determination Agent may at its option (in the case of (i)) and shall (in the case of (ii) and (iii)) (such events (i) (ii) & (iii) to be collectively referred to as "**Index Adjustment Events**") calculate the Relevant Price using in lieu of the published level for that Commodity Index (if any), the level for that Commodity Index as at the relevant determination date as determined by the Determination Agent in accordance with the formula for and method of calculating that Commodity Index last in effect prior to the relevant Index Adjustment Event (as the case may be), but using only those Futures Contracts that comprised that Index immediately prior to the relevant Index Adjustment Event (as the case may be) (other than those futures contracts that have ceased to be listed on any relevant exchange).

#### 11.7 *Definitions applicable to Commodity Notes*

In relation to Commodity Notes, the following expressions have the meanings set out below:

"**Commodity**" means each commodity specified as such in the applicable Final Terms;

"**Commodity Business Day**" means:

- (i) in the case where the Commodity Reference Price is a price announced or published by an Exchange, a day that is (or, but for the occurrence of a Commodity Disruption Event, would have been) a day on that Exchange is open for trading during its regular trading session, notwithstanding any such Exchange closing prior to its scheduled closing time; and
- (ii) in the case where the Commodity Reference Price is not a price announced or published by an Exchange, a day in respect of which the relevant Price Source published (or, but for the occurrence of a Commodity Disruption Event, would have published) a price.

"**Commodity Index**" means an index comprising commodities specified as such in the relevant Final Terms;

**"Commodity Reference Price"** means the commodity reference price(s) specified as such in the applicable Final Terms;

**"Component"** means in relation to a Commodity Index, any commodity or Futures Contract the price of which is included in such Commodity Index;

**"Delivery Date"** means the relevant date or month for delivery of the underlying Commodity (which must be a date or month reported or capable of being determined from information reported in or by the relevant Price Source) specified as such in, or determined in accordance with the provisions in, the applicable Final Terms. In relation to any underlying Commodity which is specified in the applicable Final Terms to be a "Non Metal" and each Pricing Date, the relevant Delivery Date shall be the month of expiration of the first Futures Contract to expire following such Pricing Date. In relation to any underlying Commodity which is specified in the applicable Final Terms to be a "Base Metal" or a "Precious Metal" and each Pricing Date, the Delivery Date shall be such Pricing Date;

**"DJ-AIG Commodity Index"** means the Dow Jones-AIG Commodity Index and any other Commodity Index, in each case which is calculated and sponsored by Dow Jones Inc, or any successor to such sponsor;

**"DJ-AIGCI Manual"** means the manual or handbook in respect of a DJ-AIG Commodity Index published by the sponsor of the relevant Commodity Index and in effect from time to time;

**"Exchange"** means each exchange or principal trading market specified as such in relation to a Commodity in the applicable Final Terms or in the applicable Commodity Reference Price;

**"Futures Contract"** means either (a) the contract for future delivery in respect of the relevant Delivery Date relating to the relevant Commodity referred to in the relevant Commodity Reference Price or (b) each futures contract underlying or included in a Commodity Index;

**"GS Commodity Index"** means the Goldman Sachs Commodity Index and any other Commodity Index, in each case which is calculated and sponsored by Goldman, Sachs & Co., or any successor to such sponsor;

**"GSCI Manual"** means the manual or handbook in respect of a GS Commodity Index published by the sponsor of the relevant Commodity Index and in effect from time to time;

**"Price Source"** means the publication (or such other origin of reference, including an Exchange) containing (or reporting) the Specified Price (or prices from which the Specified Price is calculated) specified as such in the applicable Final Terms;

**"Pricing Date"** means, subject as provided in this Condition 11 each date specified as such (or determined pursuant to a method specified for such purpose) in the applicable Final Terms;

**"Relevant Price"** on any day means in respect of a unit of measure of the Commodity to which a Commodity Note relates, the price, expressed as a price per unit, determined by the Determination Agent as provided in the applicable Final Terms with respect to such day for the applicable Commodity Reference Price; and

**"Specified Price"** means any of the following prices of a Commodity or Commodities or levels of a Commodity Index (which must be a price reported or capable of being determined from information reported in or by the relevant Price Source), as specified in the applicable Final Terms (and, if applicable, as of the time so specified) (a) the high price (b) the low price (c) the average of the high price and the low price (d) the closing price (e) the opening price (f) the bid price (g) the asked price (h) the average of the bid price and the asked price (i) the settlement

price (j) the official settlement price (which shall be the Specified Price for any Commodity Index, and for any Commodity specified in the applicable Final Terms as a "Non Metal") (k) the official price (l) the morning fixing (m) the afternoon fixing (which shall be the Specified Price in respect of any Commodity specified in the applicable Final Terms as a "Precious Metal") (n) the spot price or (o) any other price specified in the applicable Final Terms. The Specified Price for any Commodity specified in the applicable Final Terms as a "Precious Metal" shall be the official cash bid price.

## 12 PROVISIONS RELATING TO CURRENCY NOTES

This Condition 12 is applicable only in relation to Notes specified in the relevant Final Terms as being Currency Notes.

12.1 *Valuation Date*: "**Valuation Date**" means, in respect of any Series of Currency Notes, the date(s) specified as such or otherwise determined as provided in the applicable Final Terms provided that where the Valuation Date is not a Currency Business Day then the Valuation Date shall be the first preceding day that is a Currency Business Day, unless otherwise specified in the relevant Final Terms. Unless otherwise specified in the relevant Final Terms and subject to Condition 12.2 (*Averaging*), the Valuation Date will be the date falling two Currency Business Days prior to the Maturity Date.

12.2 *Averaging*: If Averaging Dates are specified in the relevant Final Terms, then notwithstanding any other provisions of these Conditions, the following provisions will apply to the determination of the Settlement Rate in relation to a Valuation Date:

12.2.1 "**Averaging Date**" means, in respect of a Valuation Date, each date specified as such or otherwise determined as provided in the applicable Final Terms, provided that if any such date is not a Currency Business Day, such date shall be the first preceding day that is a Currency Business Day, unless otherwise specified in the relevant Final Terms.

12.2.2 For purposes of determining the Settlement Rate in relation to a Valuation Date, the Settlement Rate will be the arithmetic mean of the Spot Rates on each Averaging Date (or, if different, the day on which rates for each Averaging Date would, in the ordinary course, be published or announced by the relevant price source).

12.2.3 Unless otherwise specified in the applicable Final Terms, in the case where it becomes impossible to obtain the Spot Rate on an Averaging Date (or, if different, the day on which rates for that Averaging Date would, in the ordinary course, be published or announced by the relevant price source), such Averaging Date will be deemed not to be a relevant Averaging Date for purposes of determining the relevant Settlement Rate. If through the operation of this Condition 12.2.3, there would not be an Averaging Date with respect to the relevant Valuation Date, the provisions of Conditions 12.3 (*Currency Disruption Events*) and 12.4 (*Currency Disruption Fallbacks*) shall apply for purposes of determining the relevant Spot Rate on the final Averaging Date with respect to that Valuation Date as if such Averaging Date were a Valuation Date on which a Price Source Disruption had occurred.

12.3 *Currency Disruption Events*:

12.3.1 If so specified in the Final Terms relating to any Series of Notes, the following shall constitute "Currency Disruption Events" for the purposes of such Series:

- (a) "**Price Source Disruption**", which means it becomes impossible, as determined by the Determination Agent, acting in a commercially



reasonable manner, to determine the Settlement Rate on the Valuation Date (or, if different, the day on which rates for that Valuation Date would, in the ordinary course, be published or announced by the applicable price source in accordance with the relevant price source); and

- (b) any other (if any) currency disruption event specified in the applicable Final Terms.

12.3.2 If the applicable Final Terms specifies that any Currency Disruption Event shall be applicable to such Series, then, where the Determination Agent determines, acting in a commercially reasonable manner, that such Currency Disruption Event has occurred and is continuing in respect of such Series:

- (a) in the case of Price Source Disruption, on the day that is the Valuation Date in respect of such Series (or, if different, the day on which rates for that Valuation Date would, in the ordinary course, be published or announced by the relevant price source); and
- (b) in the case of any other Currency Disruption Event, on such day as may be specified for this purpose in the relevant Final Terms,

then the Settlement Rate for such Series will be determined in accordance with the terms of the Currency Disruption Fallback first applicable pursuant to Condition 12.4 (*Currency Disruption Fallbacks*).

#### 12.4 *Currency Disruption Fallbacks:*

12.4.1 If so specified in the Final Terms relating to any Series of Notes, the following shall constitute "Currency Disruption Fallbacks" for the purposes of such Series, and the applicable Final Terms shall specify which Currency Disruption Fallback(s) shall apply to such Series, to which Currency Disruption Event each such Currency Disruption Fallback shall apply and, where more than one Currency Disruption Fallback may apply to a Currency Disruption Event, the order in which such Currency Disruption Fallback(s) shall apply to such Currency Disruption Event.

- (a) **"Determination Agent Determination of Settlement Rate"** means that the Determination Agent will determine, in its sole and absolute discretion, the Settlement Rate (or a method for determining the Settlement Rate), taking into consideration all available information that it deems relevant;
- (b) **"Fallback Reference Price"** means that the Determination Agent will determine, in its sole and absolute discretion, the Settlement Rate for such Series on the relevant Valuation Date (or, if different, the day on which rates for that Valuation Date would, in the ordinary course, be published or announced) pursuant to the Settlement Rate Option referred to as Currency-Reference Dealers, or pursuant to such other Settlement Rate Option as may be specified as the Fallback Reference Price in the relevant Final Terms; and
- (c) any other provisions specified as Currency Disruption Fallbacks in the relevant Final Terms.

- 12.4.2 Where more than one Currency Disruption Event occurs or exists or is deemed to occur or exist, then, unless the relevant Final Terms has specified which Currency Disruption Fallback shall apply in such circumstances, the Determination Agent shall determine, in its sole and absolute discretion, which Currency Disruption Fallback shall apply.

#### 12.5 Definitions applicable to Currency Notes

In relation to Currency Notes, the following expressions have the meanings set out below:

**"Currency Business Day"** means, unless otherwise specified in the relevant Final Terms, for the purposes of:

- (i) the definition of Valuation Date in Condition 12.1 (*Valuation Date*), in respect of any Series of Currency Notes: (1) a day on which commercial banks are (or but for the occurrence of a Currency Disruption Event, would have been) open for business (including dealings in foreign exchange in accordance with the market practice of the foreign exchange market) in the Principal Financial Centre(s) of the Reference Currency or (2) where the currency to be valued is euro, a day that is a TARGET Settlement Day and a Business Day; and
- (ii) for any other purpose, in respect of any Series of Currency Notes: (1) a day on which commercial banks are open for general business (including dealings in foreign exchange in accordance with the market practice of the foreign exchange market) in the Principal Financial Centre(s) of the Reference Currency and (2) where one of the Currency Pair is euro, a day that is a TARGET Settlement Day;

**"Currency Pair"** means the Reference Currency and the Settlement Currency;

**"Currency-Reference Dealers"** is a Settlement Rate Option which means that the Spot Rate for a Rate Calculation Date will be determined on the basis of quotations provided by Reference Dealers on that Rate Calculation Date of that day's Specified Rate, expressed as the amount of Reference Currency per one unit of Settlement Currency for settlement on the Maturity Date (or other relevant date for payment under the Notes). The Determination Agent will request each of the Reference Dealers to provide a firm quotation of its Specified Rate for a transaction where the amount of Reference Currency equals the Specified Amount. If four quotations are provided, the rate for a Rate Calculation Date will be the arithmetic mean of the Specified Rates, without regard to the Specified Rates having the highest and lowest value. If exactly three quotations are provided, the rate for a Rate Calculation Date will be the Specified Rate provided by the Reference Dealer that remains after disregarding the Specified Rates having the highest and lowest values. For this purpose, if more than one quotation has the same highest value or lowest value, then the Specified Rate of one of such quotations shall be disregarded. If exactly two quotations are provided, the rate for a Rate Calculation Date will be the arithmetic mean of the Specified Rates. If only one quotation is provided, the rate for a Rate Calculation Date will be the Specified Rate quoted by that Reference Dealer. The quotations used to determine the Spot Rate for a Rate Calculation Date will be determined in each case at the Specified Time on that Rate Calculation Date;

**"Rate Calculation Date"** means any Valuation Date or Averaging Date (as defined in Conditions 12.1 (*Valuation Date*) and 12.2 (*Averaging*) respectively);

**"Reference Currency"** means the currency specified as such in the applicable Final Terms;

**"Reference Currency Jurisdiction"** means the jurisdiction specified as such in the relevant Final Terms;

**"Reference Dealers"** means the reference dealers specified as such in the relevant Final Terms;

**"Settlement Currency"** means the currency specified as such in the applicable Final Terms;

**"Settlement Rate"** means the rate as determined by the Determination Agent, in its sole and absolute discretion, in accordance with the relevant Final Terms and, where applicable shall be determined in accordance with Condition 12.2 (*Averaging*);

**"Settlement Rate Option"** means for the purposes of calculating the Settlement Rate, the Settlement Rate Option specified in the applicable Final Terms (or which is applicable pursuant to Condition 12.4 (*Currency Disruption Fallbacks*));

**"Specified Amount"** means the amount of Reference Currency specified as such in the relevant Final Terms;

**"Specified Rate"** means any of the following rates, as specified in the relevant Final Terms: (i) the Reference Currency bid exchange rate, (ii) the Reference Currency offer exchange rate, (iii) the average of the Reference Currency bid and offer exchange rates, (iv) the Settlement Currency bid exchange rate, (v) the Settlement Currency offer exchange rate, (vi) the average of the Settlement Currency bid and offer exchange rates, (vii) the official fixing rate or (viii) any other exchange rate specified in the relevant Final Terms. If no such rate is specified, the Specified Rate will be deemed to be the average of the Reference Currency bid and offer rate;

**"Specified Time"** means, in respect of any series of Notes and the determination of the Spot Rate, the time specified as such in the applicable Final Terms or if no such time is specified the time chosen by the Determination Agent;

**"Spot Rate"** means for any Valuation Date, the relevant currency exchange rate determined in accordance with the applicable Settlement Rate Option and, if a Settlement Rate Option is not applicable, the currency exchange rate at the time at which such rate is to be determined for foreign exchange transactions in the Currency Pair for value on the Maturity Date (or other relevant date for payment under the Notes), as determined in good faith and in a commercially reasonable manner by the Determination Agent.

## **13 REDEMPTION AND PURCHASE**

13.1 *Scheduled Redemption.* Save in the case of Credit-Linked Notes, unless previously redeemed, or purchased and cancelled, and unless otherwise specified in the relevant Final Terms, (i) Cash Settlement Notes will be redeemed at their Final Redemption Amount on the Maturity Date, subject as provided in Condition 14 (*Payments*) and (ii) Physical Settlement Notes shall be redeemed by delivery of the Physical Delivery Amount on the Physical Settlement Date, subject as provided in Condition 15. Credit-Linked Notes shall be redeemed as set out in Condition 16.

13.2 *Tax Redemption - Morgan Stanley Notes.* Notes issued by Morgan Stanley may be redeemed in whole (but not in part), at the option of Morgan Stanley at any time prior to maturity, upon the giving of a notice of redemption as described below, if Morgan Stanley determines that, as a result of:

13.2.1 any change in or amendment to the laws, or any regulations or rulings promulgated under the laws, of the United States or of any political subdivision or taxing authority of or in the United States affecting taxation, or

13.2.2 any change in official position regarding the application or interpretation of the laws, regulations or rulings referred to above,

which change or amendment becomes effective on or after the date of the applicable Final Terms in connection with the issuance of the Notes or any other date specified in the applicable Final Terms, Morgan Stanley is or will become obligated to pay Additional Amounts with respect to the Notes as described in Condition 17 (*Taxation*). The redemption price will be specified in the applicable Final Terms. Morgan Stanley will give notice of any tax redemption.

13.3 *Tax Redemption - MSBV Notes and MSJ Notes.* MSBV Notes and MSJ Notes may be redeemed as a whole (but not in part), at the option of the relevant Issuer at any time prior to maturity, upon the giving of a notice of redemption as described below, if the Issuer determines that, as a result of:

- 13.3.1 any change in or amendment to the laws, or any regulations or rulings promulgated under the laws of The Netherlands, Jersey or the United States or of any political subdivision or taxing authority of or in The Netherlands, Jersey or the United States affecting taxation, or
- 13.3.2 any change in official position regarding the application or interpretation of the laws, regulations or rulings referred to above,

which change or amendment becomes effective on or after the date of the applicable Final Terms in connection with the issuance of the Notes or any other date specified in the applicable Final Terms, the Issuer or the Guarantor is or will become required by law to make any withholding or deduction with respect to the Notes, as described in Condition 17 (*Taxation*). The redemption price will be specified in the applicable Final Terms. The Issuer will give notice of any tax redemption.

13.4 Prior to the relevant Issuer giving notice of redemption under Condition 13.2 or 13.3, it will deliver to the Fiscal Agent:

- 13.4.1 a certificate stating that it is entitled to effect the redemption and setting forth a statement of facts showing that the conditions precedent to its right to so redeem have occurred (the date on which that certificate is delivered to the Fiscal Agent is the "**Redemption Determination Date**"); and
- 13.4.2 an opinion of independent legal counsel of recognised standing to that effect based on the statement of facts.

Notice of redemption will be given not less than 30 nor more than 60 days prior to the date fixed for redemption. The date and the applicable redemption price will be specified in the notice.

If any date fixed for redemption is a date prior to the date (the "**Exchange Date**") that is 40 days after the date in which the Issuer receives the proceeds of the sale of a Note, definitive bearer notes will be issuable on and after that redemption date as if that redemption date had been the Exchange Date. Receipt of Ownership Certificates, as described in "Forms of Notes" above, is a condition to delivery of definitive bearer notes.

13.5 *Special Tax Redemption.* If the Issuer determines that any payment made outside the United States by the Issuer, the Guarantor (in the case of MSBV Notes or MSJ Notes) or any Paying Agent of principal, premium, interest and/or supplemental amounts, if any, due on any bearer note or coupon would, under any present or future laws or regulations of the United States, be subject to any certification, identification or other information reporting requirement of any kind, the effect of which is the disclosure to the Issuer, the Guarantor (in the case of MSBV Notes or MSJ Notes), any Paying Agent or any governmental authority of the nationality,

residence or identity of a beneficial owner of that bearer note or coupon who is a United States Alien other than such a requirement that:

13.5.1 would not be applicable to a payment made by the Issuer, the Guarantor or any Paying Agent

- (a) directly to the beneficial owner; or
- (b) to a custodian, nominee or other agent of the beneficial owner, unless the payment by the custodian, nominee or agent to the beneficial owner would otherwise be subject to any similar requirement, or

13.5.2 can be satisfied by the custodian, nominee or other agent certifying to the effect that the beneficial owner is a United States Alien, unless the payment by the custodian, nominee or agent to the beneficial owner would otherwise be subject to any similar requirement,

the Issuer will (1) redeem the Notes, as a whole, at the redemption price specified in the applicable Final Terms, or (2) at the election of the Issuer, if the conditions described below are satisfied, pay the additional amounts specified in that paragraph.

The relevant Issuer will make the determination and election described above as soon as practicable and publish prompt notice thereof (the "**Determination Notice**") stating:

13.5.3 the effective date of the certification, identification or other information reporting requirements,

13.5.4 whether the Issuer will redeem the Notes or has elected to pay the additional amounts specified below and

13.5.5 if the Issuer elects to redeem, the last date by which the redemption of the Notes must take place.

If the Issuer redeems the Notes for this reason, the redemption will take place on a date, not later than one year after the publication of the Determination Notice. The Issuer will elect the date fixed for redemption by notice to the Fiscal Agent at least 60 days prior to the date fixed for redemption, or within the redemption notice period specified in the applicable Final Terms. Notice of the redemption of the Notes will be given to the Noteholders not more than 60 nor less than 30 days prior to the date fixed for redemption, or within the redemption notice period specified in the applicable Final Terms.

Notwithstanding the foregoing, the relevant Issuer will not redeem the Notes if such Issuer subsequently determines, not less than 30 days prior to the date fixed for redemption, or prior to the last day of the specified redemption notice period in the applicable Final Terms, that subsequent payments would not be subject to any certification, identification or other information reporting requirement, in which case the Issuer will publish prompt notice of the determination and revoke any earlier redemption notice.

13.6 *Election to pay additional amounts rather than redeem.* If and so long as the certification, identification or other information reporting requirements referred to in Condition 13.5 (*Special Tax Redemption*) would be fully satisfied by payment of a backup withholding tax or similar charge, the relevant Issuer may elect to pay such additional amounts as may be necessary so that every net payment made outside the United States following the effective date of those requirements by the Issuer, the Guarantor (if applicable) or any Paying Agent of principal, premium, interest and/or supplemental amounts, if any, due in respect of any bearer note or any

coupon of which the beneficial owner is a United States Alien will not be less than the amount provided for in the Note or Coupon to be then due and payable after deduction or withholding for or on account of the backup withholding tax or similar charge, other than a backup withholding tax or similar charge that:

- (a) would not be applicable in the circumstances referred to in Conditions 13.5.1 and 13.5.2 or
- (b) is imposed as a result of presentation of the Note or Coupon for payment more than 15 days after the date on which the payment becomes due and payable or on which payment thereof is duly provided for, whichever occurs later.

The Issuer's ability to elect to pay additional amounts as described in this paragraph is conditioned on there not being a requirement that the nationality, residence or identity of the beneficial owner be disclosed to the Issuer, the Guarantor, any paying agent or any governmental authority, as a result of the payment of the additional amounts.

If the Issuer elects to pay any additional amounts as described in this Condition 13.6, the Issuer will have the right to redeem the Notes as a whole at any time by meeting the same conditions described in Condition 13.5 (*Special Tax Redemption*), and the redemption price of the Notes will not be reduced for applicable withholding taxes. If the Issuer elects to pay additional amounts as described in this Condition 13.6 and the condition specified in the first sentence of this Condition 13.6 should no longer be satisfied, then the Issuer will redeem the Notes as a whole under the applicable provisions of Condition 13.5 (*Special Tax Redemption*).

- 13.7 *Redemption at the option of the Issuer.* If the Call Option is specified in the applicable Final Terms as being applicable, the Notes may be redeemed at the option of the Issuer in whole or, if so specified in the applicable Final Terms, in part on any Optional Redemption Date (Call) at the relevant Optional Redemption Amount (Call) on the Issuer's giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable and shall oblige the Issuer to redeem the Notes or, as the case may be, the Notes specified in such notice on the relevant Optional Redemption Date (Call) at the Optional Redemption Amount (Call) plus accrued interest (if any) to such date).
- 13.8 *Partial redemption:* If the Notes are to be redeemed in part only on any date in accordance with Condition 13.7 (*Redemption at the option of the Issuer*), the Notes to be redeemed shall be selected by the drawing of lots in such place as the Fiscal Agent approves and in such manner as the Fiscal Agent considers appropriate, subject to compliance with applicable law and the rules of each listing authority, stock exchange and/or quotation system by which the Notes have then been admitted to listing, trading and/or quotation, and the notice to Noteholders referred to in Condition 13.7 (*Redemption at the option of the Issuer*) shall specify the serial numbers of the Notes so to be redeemed. If any Maximum Redemption Amount or Minimum Redemption Amount is specified in the applicable Final Terms, then the Optional Redemption Amount (Call) shall in no event be greater than the maximum or be less than the minimum so specified.
- 13.9 *Redemption at the option of Noteholders:* If the Put Option is specified in the applicable Final Terms as being applicable, the Issuer shall, at the option of the holder of any Note redeem such Note on the Optional Redemption Date (Put) specified in the relevant Put Option Notice at the relevant Optional Redemption Amount (Put) together with interest (if any) accrued to such date. In order to exercise the option contained in this Condition 13.9, the holder of a Note must, not less than 30 nor more than 60 days before the relevant Optional Redemption Date (Put), deposit with any Paying Agent such Note together with all unmatured Coupons relating thereto and a duly completed Put Option Notice in the form obtainable from any Paying Agent.

The Paying Agent with which a Note is so deposited shall deliver a duly completed Put Option Receipt to the depositing Noteholder. No Note, once deposited with a duly completed Put Option Notice in accordance with this Condition 13.9, may be withdrawn; *provided, however*, that if, prior to the relevant Optional Redemption Date (Put), any such Note becomes immediately due and payable or, upon due presentation of any such Note on the relevant Optional Redemption Date (Put), payment of the redemption moneys is improperly withheld or refused, the relevant Paying Agent shall mail notification thereof to the depositing Noteholder at such address as may have been given by such Noteholder in the relevant Put Option Notice and shall hold such Note at its Specified Office for collection by the depositing Noteholder against surrender of the relevant Put Option Receipt. For so long as any outstanding Note is held by a Paying Agent in accordance with this Condition 13.9, the depositor of such Note and not such Paying Agent shall be deemed to be the holder of such Note for all purposes.

13.10 *Early redemption of Zero Coupon Notes:* Unless otherwise specified in the applicable Final Terms, the Redemption Amount payable on redemption of a Zero Coupon Note at any time before the Maturity Date shall be an amount equal to the sum of:

13.10.1 the Reference Price; and

13.10.2 the product of the Accrual Yield (compounded annually) being applied to the Reference Price from (and including) the Issue Date to (but excluding) the date fixed for redemption or (as the case may be) the date upon which the Note becomes due and payable.

Where such calculation is to be made for a period which is not a whole number of years, the calculation in respect of the period of less than a full year shall be made on the basis of such Day Count Fraction as may be specified in the applicable Final Terms for the purposes of this Condition 13.10 or, if none is so specified, a Day Count Fraction of 30E/360.

13.11 *Purchase:* Morgan Stanley, Morgan Stanley Jersey, MSBV or any of their respective Subsidiaries may at any time purchase Notes in the open market or otherwise and at any price.

13.12 *Cancellation:* All Notes so redeemed shall, and all Notes so purchased by Morgan Stanley, Morgan Stanley Jersey, MSBV or any of their respective Subsidiaries may, at the discretion of relevant purchaser, be cancelled (together with all unmatured Coupons attached to or surrendered with them). All Notes so redeemed, and all Notes so purchased and cancelled, may not be reissued or resold.

## 14 PAYMENTS

14.1 *Principal:* Payments of principal shall be made only against presentation and (provided that payment is made in full) surrender of Notes at the Specified Office of any Paying Agent outside the United States by cheque drawn in the currency in which the payment is due on, or by transfer to an account denominated in that currency (or, if that currency is euro, any other account to which euro may be credited or transferred) and maintained by the payee with, a bank in the Principal Financial Centre of that currency.

14.2 *Interest:* Payments of interest shall, subject to Condition 14.8 below, be made only against presentation and (provided that payment is made in full) surrender of the appropriate Coupons at the Specified Office of any Paying Agent outside the United States in the manner described in Condition 14.1 above.

14.3 *Payments in New York City:* Payments of principal or interest may be made at the Specified Office of a Paying Agent in New York City if (i) the Issuer has appointed Paying Agents

outside the United States with the reasonable expectation that such Paying Agents will be able to make payment of the full amount of the interest on the Notes in the currency in which the payment is due when due, (ii) payment of the full amount of such interest at the offices of all such Paying Agents is illegal or effectively precluded by exchange controls or other similar restrictions and (iii) payment is permitted by applicable United States law without adverse United States federal tax consequences or other adverse consequences to the Issuer or the Guarantor (if applicable).

14.4 *Payments subject to fiscal laws:* All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 17 (*Taxation*). No commissions or expenses shall be charged to the Noteholders or Couponholders in respect of such payments.

14.5 *Deductions for unmatured Coupons:* If the applicable Final Terms specifies that the Fixed Rate Note Provisions are applicable and a Note is presented without all unmatured Coupons relating thereto:

14.5.1 if the aggregate amount of the missing Coupons is less than or equal to the amount of principal due for payment, a sum equal to the aggregate amount of the missing Coupons will be deducted from the amount of principal due for payment; *provided, however*, that if the gross amount available for payment is less than the amount of principal due for payment, the sum deducted will be that proportion of the aggregate amount of such missing Coupons which the gross amount actually available for payment bears to the amount of principal due for payment;

14.5.2 if the aggregate amount of the missing Coupons is greater than the amount of principal due for payment:

(a) so many of such missing Coupons shall become void (in inverse order of maturity) as will result in the aggregate amount of the remainder of such missing Coupons (the "**Relevant Coupons**") being equal to the amount of principal due for payment; *provided, however*, that where this subparagraph would otherwise require a fraction of a missing Coupon to become void, such missing Coupon shall become void in its entirety; and

(b) a sum equal to the aggregate amount of the Relevant Coupons (or, if less, the amount of principal due for payment) will be deducted from the amount of principal due for payment; *provided, however, that*, if the gross amount available for payment is less than the amount of principal due for payment, the sum deducted will be that proportion of the aggregate amount of the Relevant Coupons (or, as the case may be, the amount of principal due for payment) which the gross amount actually available for payment bears to the amount of principal due for payment.

Each sum of principal so deducted shall be paid in the manner provided in paragraph (a) above against presentation and (provided that payment is made in full) surrender of the relevant missing Coupons.

14.6 *Unmatured Coupons void:* If the applicable Final Terms specifies that this Condition 14.6 is applicable or that the Floating Rate Note Provisions or the Index-Linked Interest Note Provisions are applicable, on the due date for final redemption of any Note or early redemption of such Note pursuant to Condition 13.2 or Condition 13.3 (*Tax Redemption*), Condition 13.5 (*Special Tax Redemption*), Condition 13.9 (*Redemption at the option of Noteholders*), Condition 13.7 (*Redemption at the option of the Issuer*) or Condition 18 (*Events of Default*), all



unmatured Coupons relating thereto (whether or not still attached) shall become void and no payment will be made in respect thereof.

- 14.7 *Payments on business days:* If the due date for payment of any amount in respect of any Note or Coupon is not a Payment Business Day in the place of presentation, the holder shall not be entitled to payment in such place of the amount due until the next succeeding Payment Business Day in such place and shall not be entitled to any further interest or other payment in respect of any such delay.
- 14.8 *Payments other than in respect of matured Coupons:* Payments of interest other than in respect of matured Coupons shall be made only against presentation of the relevant Notes at the Specified Office of any Paying Agent outside the United States (or in New York City if permitted by Condition 14.3 above).
- 14.9 *Partial payments:* If a Paying Agent makes a partial payment in respect of any Note or Coupon presented to it for payment, such Paying Agent will endorse thereon a statement indicating the amount and date of such payment.
- 14.10 *Exchange of Talons:* On or after the maturity date of the final Coupon which is (or was at the time of issue) part of a Coupon Sheet relating to the Notes, the Talon forming part of such Coupon Sheet may be exchanged at the Specified Office of the Fiscal Agent during regular business hours for a further Coupon Sheet (including, if appropriate, a further Talon but excluding any Coupons in respect of which claims have already become void pursuant to Condition 19 (*Prescription*)). Upon the due date for redemption of any Note, any unexchanged Talon relating to such Note shall become void and no Coupon will be delivered in respect of such Talon.
- 14.11 *Unavailability of Currency.* If the Specified Currency is not available to the Issuer for making payments of principal of, and premium, interest and/or additional amounts, if any, on any Note (whether due to the imposition of exchange controls or other circumstances beyond the control of the Issuer, or if the Specified Currency is no longer used by the government of the country issuing that currency or by public institutions within the international banking community for the settlement of transactions). If the Specified Currency is unavailable, the Issuer may satisfy its obligations to Noteholders by making payments on the date of payment in U.S. dollars on the basis of the prevailing exchange rate on the date of the payment or of the most recent practicable date, such rate being based on the highest bid quotation in The City of New York received by the Exchange Rate Agent at approximately 11:00 a.m., New York City time, on the second Business Day preceding the applicable payment date from three recognized foreign exchange dealers for the purchase by the quoting dealer:
- (i) of the Specified Currency for U.S. dollars for settlement on the payment date;
  - (ii) in the aggregate amount of the Specified Currency payable to those holders or beneficial owners of Notes; and
  - (iii) at which the applicable dealer commits to execute a contract.

If those bid quotations are not available, the Exchange Rate Agent will determine the Market Exchange Rate at its sole discretion. All determinations by the Exchange Rate Agent will, in the absence of manifest error, be conclusive for all purposes and binding on the Issuer, the Guarantor (if applicable) and the Noteholders. The Exchange Rate Agent will be Morgan Stanley & Co. International Limited, an affiliate of Morgan Stanley, unless otherwise noted in the applicable Final Terms. If the Exchange Rate Agent is not an affiliate of Morgan Stanley, it may be one of the dealers providing quotations.

Any payment made in U.S. dollars on the basis of the prevailing exchange rate where the required payment is in an unavailable Specified Currency will not constitute an Event of Default.

The foregoing provisions do not apply if a Specified Currency is unavailable because it has been replaced by the euro. If the euro has been substituted for a Specified Currency, the Issuer may (or will, if required by applicable law) without the consent of the holders of the affected Notes, pay the principal of, premium, if any, or interest, if any, on any Note denominated in the Specified Currency in euro instead of the Specified Currency, in conformity with legally applicable measures taken pursuant to, or by virtue of, the Treaty. Any payment made in U.S. dollars or in euro as described above where the required payment is in an unavailable Specified Currency will not constitute an Event of Default.

## 15 PHYSICAL SETTLEMENT

### 15.1 *Delivery Notice*

- (i) Each Noteholder in respect of Physical Settlement Notes, shall, on or before the scheduled date for redemption thereof (or such earlier date as the Issuer shall (i) determine is necessary for the Issuer, the Fiscal Agent, Euroclear, and/or Clearstream, Luxembourg to perform their respective obligations hereunder and (ii) notify to the Fiscal Agent and the Noteholders) send to Euroclear or Clearstream, Luxembourg, as the case may be, in accordance with its then applicable operating procedures, and the Fiscal Agent an irrevocable notice (the "**Delivery Notice**") in the form from time to time approved by the Issuer, which must:
  - (a) specify the name and address of the Noteholder;
  - (b) specify the number of Notes in respect of which he is the Noteholder;
  - (c) specify the number of the Noteholder's account at Euroclear or Clearstream, Luxembourg, as the case may be, to be debited with such Notes;
  - (d) irrevocably instruct and authorise Euroclear or Clearstream, Luxembourg, as the case may be, (A) to debit the Noteholder's account with such Notes on the Physical Settlement Date and (B) that no further transfers of the Notes specified in the Delivery Notice may be made;
  - (e) contain a representation and warranty from the Noteholder to the effect that the Notes to which the Delivery Notice relates are free from all liens, charges, encumbrances and other third party rights;
  - (f) specify the number and account name of the account at the Clearing System to be credited with the Physical Delivery Amount if Physical Settlement is applicable;
  - (g) contain an irrevocable undertaking to pay the Redemption Expenses and Taxes (if any) and an irrevocable instruction to Euroclear or Clearstream, Luxembourg, as the case may be, to debit on or after the Physical Settlement Date the cash or other account of the Noteholder with Euroclear or, as the case may be, Clearstream, Luxembourg specified in the Delivery Notice with such Redemption Expenses and Taxes;
  - (h) include a certificate of non-U.S. beneficial ownership in the form required by the Issuer; and

- (i) authorise the production of the Delivery Notice in any applicable administrative or legal proceedings.
- (ii) A Delivery Notice, once delivered to Euroclear or Clearstream, Luxembourg, shall be irrevocable and may not be withdrawn without the consent in writing of the Issuer. A Noteholder may not transfer any Note which is the subject of a Delivery Notice following delivery of such Delivery Notice to Euroclear or Clearstream, Luxembourg. A Delivery Notice shall only be valid to the extent that Euroclear or Clearstream, Luxembourg have not received conflicting prior instructions in respect of the Notes which are the subject of the Delivery Notice.
- (iii) Failure properly to complete and deliver a Delivery Notice may result in such notice being treated as null and void. Any determination as to whether such notice has been properly completed and delivered as provided shall be made by Euroclear or Clearstream, Luxembourg, as the case may be, after consultation with the Fiscal Agent and shall be conclusive and binding on the Issuer and the Noteholder.
- (iv) The Fiscal Agent shall promptly on the Business Day following receipt of such notice send a copy of the Delivery Notice to the Issuer or such person as the Issuer may previously have specified.

## 15.2 *Delivery obligation*

- 15.2.1 Subject to the other provisions of this Condition 15.2, the Issuer shall discharge its obligation to deliver the Physical Delivery Amount in respect of any Notes by delivering, or procuring the delivery of, the relevant Underlying Shares on the Physical Settlement Date to the Clearing System for credit to the account with the Clearing System specified in the Delivery Notice of the relevant Noteholder.
- 15.2.2 The number of Underlying Shares to be delivered to or for the account of each Noteholder on redemption of any Physical Settlement Notes shall be as determined in accordance with the relevant Final Terms. The Issuer may pay a residual cash amount to each Noteholder representing any fractions of Underlying Shares comprising the Physical Delivery Amount.
- 15.2.3 After delivery to or for the account of a Noteholder of the relevant Physical Delivery Amount and for such period of time as the transferor or its agent or nominee shall continue to be registered in any clearing system as the owner of the Underlying Shares comprised in such Physical Delivery Amount (the "**Intervening Period**"), none of such transferor or any agent or nominee for the Issuer or such transferor shall (i) be under any obligation to deliver to such Noteholder or any other person any letter, certificate, notice, circular, dividend or any other document or payment whatsoever received by the Issuer or such transferor, agent or nominee in its capacity as holder of such Underlying Shares, (ii) be under any obligation to exercise any rights (including voting rights) attaching to such Underlying Shares during the Intervening Period, or (iii) be under any liability to such Noteholder or any other person in respect of any loss or damage which the Noteholder or any other person may sustain or suffer as a result, whether directly or indirectly, of the Issuer or such transferor, agent or nominee being registered in the Clearing System during such Intervening Period as legal owner of such Underlying Shares.
- 15.2.4 Any amounts in respect of dividends and interest on the Underlying Shares comprising the Physical Delivery Amount to be delivered will be payable to the party that would receive such amounts according to market practice for a sale of such Underlying Shares

executed on the Exchange Business Day following the Determination Date in respect of the Notes. Any such amounts will be paid to or for credit to the account specified by the Noteholder in the relevant Delivery Notice. No right to dividends or interest on the Underlying Shares will accrue to Noteholders prior to the Determination Date.

### 15.3 *Settlement Disruption of Physical Settlement*

- 15.3.1 This Condition 15.3 shall apply only where Physical Settlement is applicable.
- 15.3.2 The Determination Agent shall determine whether or not at any time a Settlement Disruption Event has occurred in respect of Underlying Shares comprised in the Physical Delivery Amount (the "Affected Securities") and where it determines such an event has occurred and so has prevented delivery of such Affected Securities on the original day that but for such Settlement Disruption Event would have been the Physical Settlement Date, then the Physical Settlement Date will be the first succeeding day on which delivery of such Affected Securities can take place through the Clearing System unless a Settlement Disruption Event prevents settlement on each of the ten Clearing System Business Days immediately following the original date that, but for the Settlement Disruption Event, would have been the Physical Settlement Date. In that case, (a) if such Affected Securities can be delivered in any other commercially reasonable manner, then the Physical Settlement Date will be the first day on which settlement of a sale of such Affected Securities executed on that tenth Clearing System Business Day customarily would take place using such other commercially reasonable manner of delivery (which other manner of delivery will be deemed the Clearing System for the purposes of delivery of such Affected Securities), and (b) if such Affected Shares cannot be delivered in any other commercially reasonable manner, then the Physical Settlement Date will be postponed until delivery can be effected through the Clearing System or in any other commercially reasonable manner.
- 15.3.3 For the purposes hereof "**Settlement Disruption Event**" means, as determined by the Determination Agent, an event which is beyond the control of the Issuer or the transferor of any relevant Underlying Shares and as a result of which the Clearing System cannot receive or clear the transfer of such Underlying Shares.

### 15.4 *Delivery Disruption of Physical Settlement*

- 15.4.1 This Condition 15.4 shall apply only where Physical Settlement is applicable.
- 15.4.2 If the Determination Agent determines that a Delivery Disruption Event has occurred, the Determination Agent shall notify the Issuer who shall promptly notify the Noteholders, and the Issuer will then deliver, or procure the delivery of, on the Physical Settlement Date such number of Underlying Shares comprised in the Physical Delivery Amount (if any) as it can deliver, or procure the delivery of, on that date and pay such amount as in the opinion of the Determination Agent is appropriate in the circumstances by way of compensation for the non-delivery of the remainder of the Underlying Shares comprised in the Physical Delivery Amount (assuming satisfaction of each applicable condition precedent) to which the Noteholders would have been entitled under the Notes but for the occurrence of such Delivery Disruption Event, in which event the entitlements of the respective Noteholders to receive Underlying Shares on redemption shall cease and the Issuer's obligations under the Notes shall be satisfied in full upon delivery of such number of Underlying Shares and payment of such amount.
- 15.4.3 Where this Condition 15.4 falls to be applied, insofar as the Determination Agent determines to be practical, the same shall be applied as between the Noteholders on a *pro*

*rata* basis, but subject to such rounding down (whether of the amount of a payment or of a number of Underlying Shares to be delivered) and also to such other adjustments as the Determination Agent determines to be appropriate to give practical effect to such provisions.

- 15.4.4 For the purposes hereof "**Delivery Disruption Event**" means, as determined by the Determination Agent, the failure or inability, due to illiquidity in the market for the Underlying Shares comprised in the Physical Delivery Amount, by or of the Issuer to deliver, or procure the delivery of, on the Physical Settlement Date all the Underlying Shares comprised in the Physical Delivery Amount to be delivered on that date.

15.5 *Additional Definitions:* For the purposes of this Conditions 15:

"**Clearing System**" means, in respect of an Underlying Share relating to a Physical Settlement Note, the clearing system specified as such for such Underlying Share in the applicable Final Terms or any successor to such clearing system as determined by the Determination Agent. If the Final Terms do not specify a clearing system, the Clearing System will be the principal domestic system customarily used for settling trades in the relevant Underlying Shares. If the Clearing System ceases to settle trades in such Underlying Shares, the Determination Agent will, acting in good faith and in a commercially reasonable manner, select another method of delivery;

"**Clearing System Business Day**" means, in respect of a Clearing System, any day on which such Clearing System is (or, but for the occurrence of a Settlement Disruption Event, would have been) open for the acceptance and execution of settlement instructions;

"**Physical Delivery Amount**" means in respect of any Series of Physical Settlement Notes, the securities to be delivered by the Issuer to Noteholders on redemption of each Note, as provided in the applicable Final Terms;

"**Physical Settlement Date**" means, in relation to Underlying Shares to be delivered, subject to Condition 15.3 (*Settlement Disruption of Physical Settlement*), in respect of any Notes, the date following the Maturity Date or any other applicable redemption date, as the case may be, which is the first day on which settlement of a sale of such Underlying Shares executed on that Maturity Date or other redemption date, as the case may be, customarily would take place through the Applicable Clearing System, unless otherwise specified in the applicable Final Terms;

"**Settlement Disruption Event**" means, in relation to an Underlying Share, an event beyond the control of the parties as a result of which the Clearing System cannot clear the transfer of such Underlying Share.

## 16 CREDIT-LINKED NOTES

- 16.1 This Condition 16 is applicable only in relation to Notes specified in the relevant Final Terms as being Credit-Linked Notes

- 16.2 *Generally:* The terms and conditions of the Notes relating to the calculation of the Final Price of the relevant Reference Obligation, the Credit Event Redemption Amount and the Valuation Method, in the event that Conditions to Settlement are satisfied during the Notice Delivery Period, shall be set out in the applicable Final Terms. Terms used in the Final Terms for Credit-Linked Notes shall, unless otherwise defined herein or in the applicable Final Terms and where the context so permits, have the meanings given thereto in the 2003 ISDA Credit Derivatives Definitions, as amended and updated as at the date of issue of the first Tranche of the Notes of the relevant Series, as published by the International Swaps and Derivatives Association, Inc. (the "**ISDA Credit Derivatives Definitions**").

- 16.3 *Maturity*: Subject to the provisions of and in accordance with Conditions 16.4 and 16.5 and unless previously redeemed or purchased and cancelled, each Credit-Linked Note will mature and will be redeemed on the Scheduled Maturity Date, and the Issuer will on the Scheduled Maturity Date at the option of the Issuer either (a) pay or cause to be paid, for value on the Scheduled Maturity Date, the Final Redemption Amount in respect of such Note to the holder thereof or (b) subject to Condition 15 (*Physical Settlement*) deliver the Deliverable Amount in respect of such Note to the holder thereof on the Physical Settlement Date, in each case subject to any applicable fiscal or other laws or regulations and subject to and in accordance with the terms and conditions set out herein and in the applicable Final Terms. Payment of any applicable Taxes and Redemption Expenses shall be made by the relevant Noteholder, and the Issuer shall not have any liability in respect thereof.
- 16.3.1 Credit-Linked Notes do not give the Noteholder any right to acquire any of the Reference Obligations or Deliverable Obligations, and the Issuer is not obliged to purchase, hold or deliver any of such Reference Obligations or Deliverable Obligations. However, if so specified in the relevant Final Terms, the Issuer may, on the redemption of such a Note, elect to deliver the Deliverable Amount on the relevant Physical Settlement Date and the Noteholder shall be obliged to accept such Deliverable Amount.
- 16.3.2 If the Issuer does not elect to deliver the Deliverable Amount, the Issue and Paying Agent shall give notice to the relevant Noteholders in accordance with Condition 24 of the Redemption Amount payable in cash in respect of each Note as soon as practicable after calculation of such amount.
- 16.4 *Cash Settlement*: If Cash Settlement is specified in the applicable Final Terms and the Conditions to Settlement are satisfied during the Notice Delivery Period (such date of satisfaction the "**Credit Event Determination Date**"), the Issuer may, at its option, give notice (such notice a "**Settlement Notice**") to the Noteholders in accordance with Condition 24 and redeem all of the relevant Credit-Linked Notes, each Note being redeemed by the Issuer at the Credit Event Redemption Amount on the Credit Event Redemption Date.
- 16.4.1 If the Conditions to Settlement are satisfied and the relevant Credit-Linked Notes become redeemable in accordance with this Condition 16.4, upon payment of the Credit Event Redemption Amount in respect of such Notes the Issuer shall have discharged its obligations in respect of such Notes and shall have no other liability or obligation whatsoever in respect thereof. The Credit Event Redemption Amount may be less than the principal amount of such a Note. Any shortfall shall be borne by the Noteholders, and no liability shall attach to the Issuer.
- 16.5 *Physical Settlement*: If Physical Settlement is specified in the applicable Final Terms and Conditions to Settlement are satisfied during the Notice Delivery Period (such date of satisfaction the "**Credit Event Determination Date**"), the Issuer may, at its option, give notice (such notice a "**Notice of Physical Settlement**") to the Noteholders in accordance with Condition 24 and redeem all but not some only of the Notes, each Note being redeemed by delivery of the Deliverable Obligations comprising the Deliverable Amount, subject to and in accordance with Condition 15. If the Issuer elects not to give a Notice of Physical Settlement, Condition 16.4 shall apply.
- 16.5.1 In the Notice of Physical Settlement the Issuer shall specify the Deliverable Obligations comprising the Deliverable Amount that it reasonably expects to deliver. For the avoidance of doubt, the Determination Agent shall be entitled to select any of the Deliverable Obligations to constitute the Deliverable Amount, irrespective of their market value.

- 16.5.2 If Conditions to Settlement are satisfied and the Credit-Linked Notes become redeemable in accordance with this Condition 16.5, upon delivery of the Deliverable Amount, the Issuer shall have discharged its obligations in respect of such Notes and shall have no other liability or obligation whatsoever in respect thereof. The value of such Deliverable Amount may be less than the principal amount of such Note. Any shortfall shall be borne by the Noteholders, and no liability shall attach to the Issuer.
- 16.6 *Repudiation/Moratorium Extension:* Where Repudiation/Moratorium is a Credit Event specified in the applicable Final Terms and Conditions to Settlement have not been satisfied on or prior to the Scheduled Maturity Date but the Repudiation/Moratorium Extension Condition has been satisfied on or prior to the Scheduled Maturity Date and the Repudiation/Moratorium Evaluation Date in respect of such Potential Repudiation/Moratorium will in the sole determination of the Determination Agent fall after the Scheduled Maturity Date, then the Determination Agent shall notify the Noteholders in accordance with Condition 24 that a Potential Repudiation/Moratorium has occurred, and:
- 16.6.1 where a Repudiation/Moratorium has not occurred on or prior to the Repudiation/Moratorium Evaluation Date, each Credit-Linked Note will be redeemed by the Issuer by payment of the Redemption Amount on the second Business Day following the final day of the Notice Delivery Period; and
- 16.6.2 where a Repudiation/Moratorium has occurred on or prior to the Repudiation/Moratorium Evaluation Date and Conditions to Settlement are satisfied in the Notice Delivery Period, the provisions of Condition 16.4 or 16.5 as applicable shall apply to such Credit-Linked Notes.
- 16.7 *Grace Period Extension:* If "Grace Period Extension" is specified as applying in the relevant Final Terms, the provisions of this Condition 16.7 shall apply.
- Where Conditions to Settlement have not been satisfied on or prior to the Scheduled Maturity Date but a Potential Failure to Pay has occurred with respect to one or more Obligations in respect of which a Grace Period is applicable on or prior to the Scheduled Maturity Date (and such Grace Period(s) is/are continuing as of the Scheduled Maturity Date), then:
- 16.7.1 where a Failure to Pay has not occurred on or prior to the Grace Period Extension Date each Credit-Linked Note will be redeemed by the Issuer by payment of the Redemption Amount on the second Business Day following the final day of the Notice Delivery Period; and
- 16.7.2 where a Failure to Pay has occurred on or prior to the Grace Period Extension Date and Conditions to Settlement are satisfied in the Notice Delivery Period, the provisions of Condition 16.4 or 16.5 as applicable shall apply to such Notes.
- 16.8 *Maturity Date Extension:* If on (1) the Scheduled Maturity Date or (2) the Repudiation/Moratorium Evaluation Date, or (3) if "Grace Period Extension" is specified as applying in the applicable Final Terms, the Grace Period Extension Date, as the case may be, Conditions to Settlement have not been satisfied but, in the opinion of the Determination Agent, a Credit Event may have occurred, the Determination Agent may notify the Noteholders in accordance with Condition 24 that the Scheduled Maturity Date, the Grace Period Extension Date or the Repudiation/Moratorium Evaluation Date, as the case may be, has been postponed to a date (such date the "**Postponed Maturity Date**") specified in such notice falling not more than 15 calendar days after the Scheduled Maturity Date, the Grace Period Extension Date or the Repudiation/Moratorium Evaluation Date, as the case may be, and:

16.8.1 where Conditions to Settlement are not satisfied on or prior to the Postponed Maturity Date subject as provided below each Credit-Linked Note will be redeemed by the Issuer by payment of the Redemption Amount on the Postponed Maturity Date; and

16.8.2 where Conditions to Settlement are satisfied on or prior to the Postponed Maturity Date, the provisions of Condition 16.4 or 16.5 as applicable shall apply to such Notes.

#### 16.9 *Definitions applicable to Credit-Linked Notes*

In relation to Credit-Linked Notes, the following expressions have the meanings set out below:

**"Conditions to Settlement"** means the delivery by the Determination Agent to the Issuer of a Credit Event Notice that is effective during the Notice Delivery Period and the further conditions, if any, set out in the applicable Final Terms;

**"Credit Event"** means the occurrence during the Notice Delivery Period of any one or more of the Credit Events specified in the applicable Final Terms, as determined by the Determination Agent;

If an occurrence would otherwise constitute a Credit Event, such occurrence will constitute a Credit Event whether or not such occurrence arises directly or indirectly from, or is subject to a defence based upon:

- (a) any lack or alleged lack of authority or capacity of a Reference Entity to enter into any Obligation;
- (b) any actual or alleged unenforceability, illegality, impossibility or invalidity with respect to any Obligation however described;
- (c) any applicable law, order, regulation, decree or notice, however described, or the promulgation of, or any change in, the interpretation by any court, tribunal, regulatory authority or similar administrative or judicial body with competent or apparent jurisdiction of any applicable law, order, regulation, decree or notice, however described; or
- (d) the imposition of, or any change in, any exchange controls, capital restrictions or any other similar restrictions imposed by any monetary or other authority, however described.

**"Credit Event Determination Date"** means the date on which the Conditions to Settlement in respect of a Credit-Linked Note are satisfied;

**"Credit Event Notice"** means, subject as provided in the applicable Final Terms, an irrevocable notice from the Determination Agent to the Issuer that describes a Credit Event that occurred during the Notice Delivery Period. A Credit Event Notice must contain a description in reasonable detail of the facts relevant to the determination that a Credit Event has occurred. The Credit Event that is the subject of the Credit Event Notice need not be continuing on the date the Credit Event Notice is effective;

**"Credit Event Redemption Amount"** means the amount calculated in the manner and in accordance with the formula specified in the applicable Final Terms;

**"Credit Event Redemption Date"** means the Business Day following the number of Business Days specified in the applicable Final Terms after the calculation of the Final Price or the Credit Event Determination Date, as the case may be;



**"Default Requirement"** means the amount specified as such in the applicable Final Terms, or if none is specified, US\$10,000,000 or its equivalent as calculated by the Determination Agent in the relevant currency as of the occurrence of the relevant Credit Event;

**"Deliverable Amount"** means, in respect of each nominal amount of Notes equal to the lowest denomination, Deliverable Obligations as selected by the Determination Agent in its sole discretion with:

- (a) in the case of Deliverable Obligations that are Borrowed Money, an outstanding principal balance (including accrued but unpaid interest (as determined by the Determination Agent) if "Include Accrued Interest" is specified as applying in the applicable Final Terms, but excluding accrued but unpaid interest if "Exclude Accrued Interest" is specified as applying in the applicable Final Terms, and if neither "Include Accrued Interest" nor "Exclude Accrued Interest" is specified as applying in the applicable Final Terms, excluding accrued but unpaid interest); or
- (b) in the case of Deliverable Obligations that are not Borrowed Money, a Due and Payable Amount

(or, in the case of either (a) or (b), the equivalent Currency Amount of any such amount), in an aggregate amount as of the relevant Delivery Date equal to the lowest denomination of a Note less Deliverable Obligations with a market value determined by the Determination Agent in its sole discretion on the Business Day selected by the Determination Agent falling during the period from and including the Credit Event Determination Date to and including the Delivery Date equal to any costs which the applicable Final Terms specify are to be deducted from the Deliverable Amount (which may, without limitation, include the costs of the Issuer incurred in connection with the redemption of the Notes and related termination or re-establishment of any hedge or related trading position).

If an obligation by its terms represents or contemplates an obligation to pay an amount greater than the outstanding principal balance of such obligation as of the Delivery Date as a result of the occurrence or non-occurrence of an event or circumstance, the outstanding principal balance of such obligation shall not include any additional amount that would be payable upon the occurrence or non-occurrence of such event or circumstance;

**"Deliverable Obligations"** has the meaning set out in the applicable Final Terms;

**"Delivery Date"** means the date on which Deliverable Obligations are delivered;

**"Due and Payable Amount"** means the amount that is due and payable under (and in accordance with the terms of) a Deliverable Obligation on the Delivery Date, whether by reason of acceleration, maturity, termination or otherwise (excluding sums in respect of default interest, indemnities, tax gross-ups and other similar amounts);

**"Failure to Pay"** has the meaning specified in the applicable Final Terms or, if no such meaning is so specified, means, following the expiration of any applicable Grace Period (after the satisfaction of any conditions precedent to the commencement of such Grace Period), the failure by a Reference Entity to make, when and where due, any payments in an aggregate amount of not less than the Payment Requirement under one or more Obligations in accordance with the terms of such Obligations at the time of such failure;

**"Final Price"** means, in respect of a Series, the price of the Reference Obligation, expressed as a percentage, determined in accordance with the Valuation Method specified in the relevant Final Terms;

**"Grace Period"** means:

- (a) subject to paragraphs (b) and (c) below, the applicable grace period with respect to payments under the relevant Obligation under the terms of such Obligation in effect as of the later of the Trade Date and the date as of which such Obligation is issued or incurred.
- (b) if Grace Period Extension is specified as applying in the applicable Final Terms, a Potential Failure to Pay has occurred on or prior to the Scheduled Maturity Date and the applicable grace period cannot, by its terms, expire on or prior to the Scheduled Maturity Date, the Grace Period shall be deemed to be the lesser of such grace period and the period specified as such in the applicable Final Terms or, if no period is specified in the applicable Final Terms, 30 calendar days; and
- (c) if, at the later of the Trade Date and the date as of which an Obligation is issued or incurred, no grace period with respect to payments or a grace period with respect to payments of less than three Grace Period Business Days is applicable under the terms of such Obligation, a Grace Period of three Grace Period Business Days shall be deemed to apply to such Obligation; provided that, unless Grace Period Extension is specified as applying in the applicable Final Terms, such deemed Grace Period shall expire no later than the Scheduled Maturity Date;

**"Grace Period Business Day"** means a day on which commercial banks and foreign exchange markets are generally open to settle payments in the place or places and on the days specified for that purpose in the relevant Obligation;

**"Grace Period Extension Date"** means, if:

- (a) Grace Period Extension is specified as applying in the applicable Final Terms, and
- (b) a Potential Failure to Pay occurs on or prior to the Scheduled Maturity Date,

the day that is the number of days in the Grace Period after the date of such Potential Failure to Pay;

**"Notice Delivery Period"** means the period from and including the Issue Date to and including (a) the Scheduled Maturity Date; (b) the date that is fourteen calendar days after the Grace Period Extension Date if (i) Grace Period Extension is specified as applicable in the applicable Final Terms, (ii) the Credit Event that is the subject of the Credit Event Notice is a Failure to Pay that occurs after the Scheduled Maturity Date and (iii) the Potential Failure to Pay with respect to such Failure to Pay occurs on or prior to the Scheduled Maturity Date; or (c) the date that is fourteen calendar days after the Repudiation/Moratorium Evaluation Date if (i) the Credit Event that is the subject of the Credit Event Notice is a Repudiation/Moratorium that occurs after the Scheduled Maturity Date, (ii) the Potential Repudiation/Moratorium with respect to such Repudiation/Moratorium occurs on or prior to the Scheduled Maturity Date and (iii) the Repudiation/Moratorium Extension Condition is satisfied;

**"Obligations"** has the meaning set out in the applicable Final Terms;

**"Payment Requirement"** means the amount specified as such in the applicable Final Terms or, if a Payment Requirement is not specified in the applicable Final Terms, US\$1,000,000, or its equivalent in the relevant currency as calculated by the Determination Agent, in either case, as of the occurrence of the relevant Failure to Pay or Potential Failure to Pay, as applicable;

**“Physical Delivery Amount”** means in respect of any Series of Physical Settlement Notes, the securities to be delivered by the Issuer to Noteholders on redemption of each Note, as provided in the applicable Final Terms;

**“Physical Settlement Date”** means, in relation to Underlying Shares to be delivered, subject to Condition 15.3 (*Settlement Disruption of Physical Settlement*), in respect of any Notes, the date following the Maturity Date or any other applicable redemption date, as the case may be, which is the first day on which settlement of a sale of such Underlying Shares executed on that Maturity Date or other redemption date, as the case may be, customarily would take place through the applicable Clearing System, unless otherwise specified in the applicable Final Terms;

**“Potential Failure to Pay”** means the failure by a Reference Entity to make, when and where due, any payments in an aggregate amount of not less than the Payment Requirement under one or more Obligations, without regard to any grace period or any conditions precedent to the commencement of any grace period applicable to such Obligations, in accordance with the terms of such Obligations at the time of such failure;

**“Reference Entity”** means each entity named as such in the applicable Final Terms (if any are so specified or described);

**“Reference Obligation”** means each obligation specified or of a type described as such in the applicable Final Terms (if any are so specified or described);

**“Repudiation/Moratorium”** has the meaning set out in the applicable Final Terms;

**“Repudiation/Moratorium Evaluation Date”** has the meaning set out in the applicable Final Terms;

**“Repudiation/Moratorium Extension Condition”** has the meaning set out in the applicable Final Terms;

**“Scheduled Maturity Date”** has the meaning specified in the applicable Final Terms;

**“Valuation Method”** means, in respect of a Credit-Linked Note, the valuation method specified as such in the applicable Final Terms; and

## 17 TAXATION

- 17.1 *Notes issued by Morgan Stanley: Additional Amounts.* In respect of a Series of Morgan Stanley Notes and except as otherwise provided in the applicable Final Terms, Morgan Stanley will, subject to certain exceptions and limitations set forth below, pay those additional amounts (the **“Additional Amounts”**) to any Noteholder or Couponholder who is a United States Alien as may be necessary in order that every net payment of the principal of and interest on the Note or Coupon and any other amounts payable on the Note or Coupon after withholding for or on account of any present or future tax, assessment or governmental charge imposed upon or as a result of that payment by the United States or any political subdivision or taxing authority thereof or therein, will not be less than the amount provided for in the Note or Coupon to be then due and payable.

Morgan Stanley will not, however, be required to make any payment of Additional Amounts to any Noteholder or Couponholder for or on account of::

- 17.1.1 any present or future tax, assessment or other governmental charge that would not have been so imposed but for:

- (a) the existence of any present or former connection between the Noteholder or Couponholder, or between a fiduciary, settlor, beneficiary, member or shareholder of the Noteholder or Couponholder, if the Noteholder or Couponholder is an estate, a trust, a partnership or a corporation, and the United States and its possessions, including, without limitation, the Noteholder or Couponholder, or such fiduciary, settlor, beneficiary, member or shareholder, being or having been a citizen or resident of the United States or being or having been engaged in a trade or business or present in the United States or having, or having had, a permanent establishment in the United States, or
  - (b) the presentation by the Noteholder or Couponholder for payment on a date more than 15 days after the date on which payment became due and payable or the date on which payment thereof is duly provided for, whichever occurs later;
- 17.1.2 any estate, inheritance, gift, sales, transfer, capital gains, corporation, income or personal property tax or any similar tax, assessment or governmental charge;
- 17.1.3 any tax, assessment or other governmental charge imposed by reason of the Noteholder's or Couponholder's past or present status as a personal holding company or foreign personal holding company or controlled foreign corporation or passive foreign investment company with respect to the United States or as a corporation that accumulates earnings to avoid United States federal income tax or as a private foundation or other tax-exempt organization;
- 17.1.4 any tax, assessment or other governmental charge that is payable otherwise than by withholding from payments on or in respect of any Note;
- 17.1.5 any tax, assessment or other governmental charge that would not have been imposed but for the failure to comply with certification, information or other reporting requirements concerning the nationality, residence or identity of the holder or beneficial owner of that Note, if compliance is required by statute or by regulation of the United States or of any political subdivision or taxing authority thereof or therein as a precondition to relief or exemption from the tax, assessment or other governmental charge;
- 17.1.6 any tax, assessment or other governmental charge imposed by reason of the Noteholder's or Couponholder's past or present status as the actual or constructive owner of 10% or more of the total combined voting power of all classes of stock entitled to vote of Morgan Stanley or as a direct or indirect subsidiary of Morgan Stanley;
- 17.1.7 presented for payment by or on behalf of a Noteholder or Couponholder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a member state of the European Union;
- 17.1.8 where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to the European Union Directive 2003/48/EC on the taxation of savings income (the "**Directive**") or any law implementing or complying with or introduced in order to conform to the Directive; or
- 17.1.9 any combination of the items listed above.

Nor will Additional Amounts be paid with respect to any payment on a Note to a United States Alien who is a fiduciary or partnership or other than the sole beneficial owner of that payment to the extent that payment would be required by the laws of the United States (or any political subdivision thereof) to be included in the income, for tax purposes, of a

beneficiary or settlor with respect to the fiduciary or a member of that partnership or a beneficial owner who would not have been entitled to the Additional Amounts had that beneficiary, settlor, member or beneficial owner been the Noteholder or Couponholder.

The term "United States Alien" means any person who, for United States federal income tax purposes, is a foreign corporation, a nonresident alien individual, a nonresident alien fiduciary of a foreign estate or trust, or a foreign partnership one or more of the members of which is a foreign corporation, a nonresident alien individual or a nonresident alien fiduciary of a foreign estate or trust.

- 17.2 *MSJ Notes and MSBV Notes.* Except as otherwise provided in the applicable Final Terms, all payments of principal and interest by Morgan Stanley Jersey or MSBV and the Guarantor in respect of MSJ Notes or MSBV Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied collected, withheld or assessed by (i) in the case where the Issuer is Morgan Stanley Jersey, Jersey; (ii) in the case where the Issuer is MSBV, The Netherlands; or (iii) in the case of the Guarantor, the United States of America or, in each case, any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. Neither Morgan Stanley Jersey nor MSBV nor (in respect of MSJ Notes or MSBV Notes) the Guarantor shall be required to make any additional payments on account of any such withholding or deductions.

## 18 EVENTS OF DEFAULT

- 18.1 If any of the following events (each, an "**Event of Default**") occurs and is continuing:

- 18.1.1 *Non-payment:* in the case of Morgan Stanley Notes, the Issuer or, in the case of MSBV Notes and MSJ Notes, either the Issuer or Guarantor fails to pay any amount of principal in respect of the Notes within seven days of the due date for payment thereof or fails to pay any amount of interest in respect of the Notes within thirty days of the due date for payment thereof; or
- 18.1.2 *Breach of other obligations:* in the case of Morgan Stanley Notes, the Issuer or, in the case of MSBV Notes and MSJ Notes, either the Issuer or Guarantor defaults in the performance or observance of any of its other obligations under or in respect of the Notes and such default remains unremedied for sixty days after written notice thereof, addressed to the Issuer by Noteholders of not less than twenty-five per cent. in principal amount of the relevant Series, has been delivered to the Issuer and to the Specified Office of the Fiscal Agent; or
- 18.1.3 *Insolvency etc:* (i) in the case of Morgan Stanley Notes, the Issuer or, in the case of MSBV Notes and MSJ Notes, either the Issuer or the Guarantor becomes insolvent or is unable to pay its debts as they fall due, (ii) an administrator or liquidator of the Issuer or the Guarantor or the whole or a substantial part of the undertaking, assets and revenues of the Issuer or the Guarantor is appointed (otherwise than for the purposes of or pursuant to an amalgamation, reorganization or restructuring while solvent), (iii) the Issuer or the Guarantor takes any action for a composition with or for the benefit of its creditors generally, or (iv) an order is made or an effective resolution is passed for the winding up, liquidation or dissolution of the Issuer or the Guarantor (otherwise than for the purposes of or pursuant to an amalgamation, reorganisation or restructuring whilst solvent).

then Noteholders of not less than 25% in aggregate principal amount of the Notes may, by written notice addressed to the Issuer and delivered to the Issuer or to the Specified Office of the

Fiscal Agent, declare the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their Early Termination Amount together with accrued interest (if any) (or in accordance with any other provisions specified in the applicable Final Terms or unless such Notes are Exchangeable Notes) without further action or formality. Notice of any such declaration shall promptly be given to the Noteholders.

- 18.2 *Annulment of Acceleration and Waiver of Defaults.* In some circumstances, if any or all Events of Default, other than the non-payment of the principal of the Notes of a Series that has become due as a result of an acceleration, have been cured, waived or otherwise remedied, then the holders of a majority in principal amount of such Series of Notes (voting as one class) may annul past declarations of acceleration of or waive past defaults of the Notes. However, any continuing default in payment of principal of or any premium or interest on those Notes may not be waived.

## **19 PRESCRIPTION**

Claims for principal shall become void unless the relevant Notes are presented for payment within ten years of the appropriate Relevant Date. Claims for interest shall become void unless the relevant Coupons are presented for payment within five years of the appropriate Relevant Date.

## **20 REPLACEMENT OF NOTES AND COUPONS**

If any Note or Coupon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the Specified Office of the Fiscal Agent during normal business hours (and, if the Notes are then admitted to listing, trading and/or quotation by any listing authority, stock exchange and/or quotation system which requires the appointment of a Paying Agent in any particular place, the Paying Agent having its Specified Office in the place required by such listing authority, stock exchange and/or quotation system), subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may reasonably require. Mutilated or defaced Notes or Coupons must be surrendered before replacements will be issued.

## **21 AGENTS**

- 21.1 In acting under the Issue and Paying Agency Agreement and in connection with the Notes and the Coupons, the Paying Agents act solely as agents of the Issuer and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders or Couponholders.
- 21.2 The initial Fiscal Agent and its initial Specified Office are listed below on the inside back cover of this Base Prospectus. The initial Calculation Agent is the Fiscal Agent. The Issuer reserves the right at any time to vary or terminate the appointment of any Paying Agent and to appoint a successor Fiscal Agent or Calculation Agent and additional or successor paying agents; *provided, however, that:*
- 21.2.1 there shall at all times be a Fiscal Agent appointed in respect of the Notes;
  - 21.2.2 if a Calculation Agent is specified in the applicable Final Terms, the Issuer shall at all times maintain a Calculation Agent;
  - 21.2.3 if and for so long as the Notes are admitted to listing, trading and/or quotation by any listing authority, stock exchange and/or quotation system which requires the appointment

of a Paying Agent in any particular place, the Issuer shall maintain a Paying Agent having its Specified Office in the place required by such listing authority, stock exchange and/or quotation system; and

21.2.4 the Issuer will at all times maintain a Paying Agent with a Specified Office in a member state of the European Union that will not be obliged to withhold or deduct tax pursuant to European Union Directive 2003/48/EC on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to that Directive.

21.3 Notice of any change in any of the Paying Agents or in their Specified Offices shall promptly be given to the Noteholders.

## **22 MEETINGS OF NOTEHOLDERS AND MODIFICATION**

22.1 *Meetings of Noteholders:* The Issue and Paying Agency Agreement contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions. Any such modification may be made if sanctioned by an Extraordinary Resolution. Such a meeting may be convened by the Issuer and shall be convened by it upon the request in writing of Noteholders holding not less than one-tenth of the aggregate principal amount of the outstanding Notes. The quorum at any meeting convened to vote on an Extraordinary Resolution will be two or more Persons holding or representing one more than half of the aggregate principal amount of the outstanding Notes or, at any adjourned meeting, two or more Persons being or representing Noteholders whatever the principal amount of the Notes held or represented; provided, however, that Reserved Matters may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more Persons holding or representing not less than three-quarters or, at any adjourned meeting, one quarter of the aggregate principal amount of the outstanding Notes form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders and Couponholders, whether present or not.

In addition, a resolution in writing signed by or on behalf of all Noteholders who for the time being are entitled to receive notice of a meeting of Noteholders will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

22.2 *Modification:* The Notes and these Conditions may be amended without the consent of the Noteholders or the Couponholders to correct a manifest error or to effect a modification which is of a formal, minor or technical nature or which, in the opinion of the Issuer and the Fiscal Agent, is not materially prejudicial to the interest of the Noteholders. In addition, the parties to the Issue and Paying Agency Agreement may agree to modify any provision thereof, but the Issuer shall not agree, without the consent of the Noteholders, to any such modification unless it is of a formal, minor or technical nature, it is made to correct a manifest error or it is, in the opinion of such parties, not materially prejudicial to the interests of the Noteholders.

22.3 In connection with the Conditions, the Issuer and the Fiscal Agent shall have regard to the interests of the Noteholders and the Couponholders as a class. In particular, but without limitation, the Issuer and the Fiscal Agent shall not have regard to the consequences for individual Noteholders or Couponholders resulting from such individual Noteholders or Couponholders being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory.

## 23 FURTHER ISSUES

Any of the Issuers may from time to time, without the consent of the Noteholders or the Couponholders, create and issue further notes having the same terms and conditions as the Notes in all respects (or in all respects except for the first payment of interest) so as to form a single series with the Notes.

## 24 NOTICES

Notices to the Noteholders shall be valid if published in leading English language daily newspapers published in London (which is expected to be the *Financial Times*) or, if such publication is not practicable, in a leading English language daily newspaper having general circulation in Europe. Any such notice shall be deemed to have been given on the date of first publication (or if required to be published in more than one newspaper, on the first date on which publication shall have been made in all the required newspapers). Couponholders shall be deemed for all purposes to have notice of the contents of any notice given to the Noteholders.

## 25 CURRENCY INDEMNITY

25.1 If any sum due from the Issuer in respect of the Notes or the Coupons or any order or judgment given or made in relation thereto has to be converted from the currency (the "**first currency**") in which the same is payable under these Conditions or such order or judgment into another currency (the "**second currency**") for the purpose of (a) making or filing a claim or proof against the Issuer, (b) obtaining an order or judgment in any court or other tribunal or (c) enforcing any order or judgment given or made in relation to the Notes, the Issuer shall indemnify each Noteholder, on the written demand of such Noteholder addressed to the Issuer and delivered to the Issuer or to the Specified Office of the Fiscal Agent, against any loss suffered as a result of any discrepancy between (i) the rate of exchange used for such purpose to convert the sum in question from the first currency into the second currency and (ii) the rate or rates of exchange at which such Noteholder may in the ordinary course of business purchase the first currency with the second currency upon receipt of a sum paid to it in satisfaction, in whole or in part, of any such order, judgment, claim or proof.

25.2 This indemnity constitutes a separate and independent obligation of the Issuer and shall give rise to a separate and independent cause of action.

## 26 ROUNDING

For the purposes of any calculations referred to in these Conditions (unless otherwise specified in these Conditions or the applicable Final Terms), (a) all percentages resulting from such calculations will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point (with 0.000005% rounded up to 0.00001%), (b) all U.S. dollar amounts used in or resulting from such calculations will be rounded to the nearest cent (with one-half cent rounded upward), (c) all Japanese Yen amounts used in or resulting from such calculations will be rounded downward to the next lower whole Japanese Yen amount and (d) all amounts denominated in any other currency used in or resulting from such calculations will be rounded to the nearest two decimal places in such currency (with 0.005 rounded up to 0.01).

## 27 REDENOMINATION, RENOMINALISATION AND RECONVENTIONING

27.1 *Application:* This Condition 27 (*Redenomination, Renominalisation and Reconventioning*) is applicable to the Notes only if it is specified in the applicable Final Terms as being applicable.



27.2 *Notice of redenomination:* If the country of the Specified Currency becomes or, announces its intention to become, a Participating Member State, the Issuer may, without the consent of the Noteholders and Couponholders, on giving at least 30 days' prior notice to the Noteholders and the Paying Agents, designate a date (the "**Redenomination Date**"), being an Interest Payment Date under the Notes falling on or after the date on which such country becomes a Participating Member State.

27.3 *Redenomination:* Notwithstanding the other provisions of these Conditions, with effect from the Redenomination Date:

27.3.1 the Notes shall be deemed to be redenominated into euro in the denomination of euro 0.01 with a principal amount for each Note equal to the principal amount of that Note in the Specified Currency, converted into euro at the rate for conversion of such currency into euro established by the Council of the European Union pursuant to the Treaty (including compliance with rules relating to rounding in accordance with European Community regulations); provided, however, that, if the Issuer determines, with the agreement of the Fiscal Agent that the then market practice in respect of the redenomination into euro 0.01 of internationally offered securities is different from that specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Noteholders and Couponholders, each listing authority, stock exchange and/or quotation system (if any) by which the Notes have been admitted to listing, trading and/or quotation and the Paying Agents of such deemed amendments;

27.3.2 if Notes have been issued in definitive form:

- (a) all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Notes) will become void with effect from the date (the "**Euro Exchange Date**") on which the Issuer gives notice (the "**Euro Exchange Notice**") to the Noteholders that replacement Notes and Coupons denominated in euro are available for exchange (provided that such Notes and Coupons are available) and no payments will be made in respect thereof;
- (b) the payment obligations contained in all Notes denominated in the Specified Currency will become void on the Euro Exchange Date but all other obligations of the Issuer thereunder (including the obligation to exchange such Notes in accordance with this Condition 27) shall remain in full force and effect; and
- (c) new Notes and Coupons denominated in euro will be issued in exchange for Notes and Coupons denominated in the Specified Currency in such manner as the Fiscal Agent may specify and as shall be notified to the Noteholders in the Euro Exchange Notice; and
- (d) all payments in respect of the Notes (other than, unless the Redenomination Date is on or after such date as the Specified Currency ceases to be a sub-division of the euro, payments of interest in respect of periods commencing before the Redenomination Date) will be made solely in euro by cheque drawn on, or by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) maintained by the payee with, a bank in the principal financial centre of any Member State of the European Communities.

27.4 *Interest:* Following redenomination of the Notes pursuant to this Condition 27, where Notes have been issued in definitive form, the amount of interest due in respect of the Notes will be

calculated by reference to the aggregate principal amount of the Notes presented (or, as the case may be, in respect of which Coupons are presented) for payment by the relevant holder.

- 27.5 *Interest Determination Date:* If the Floating Rate Note Provisions are specified in the applicable Final Terms as being applicable and Screen Rate Determination is specified in the applicable Final Terms as the manner in which the Rate(s) of Interest is/are to be determined, with effect from the Redenomination Date the Interest Determination Date shall be deemed to be the second TARGET Settlement Day before the first day of the relevant Interest Period.

## 28 SUBSTITUTION

- 28.1 *Notes issued by Morgan Stanley:* Subject to such conditions as Morgan Stanley may agree with the Fiscal Agent, but without the consent of the holders of Notes or the Coupons appertaining thereto (if any), Morgan Stanley may, subject to the Notes and the Coupons appertaining thereto being unconditionally and irrevocably guaranteed by Morgan Stanley, substitute a subsidiary of Morgan Stanley in place of Morgan Stanley as principal debtor under the Notes and the Coupons appertaining thereto (if any) where Morgan Stanley is the Issuer.
- 28.2 *MSJ Notes and MSBV Notes:* Subject to such amendment of the deed of covenant entered into by the Issuer relating to the Notes dated (i) where the Issuer is Morgan Stanley Jersey, 10 June 2002 or (ii) where the Issuer is MSBV, 4 May 2004 and such other conditions as the Issuer may agree with the Fiscal Agent, but without the consent of the holders of Notes or the Coupons appertaining thereto (if any), the Issuer may, subject to the Notes and the Coupons appertaining thereto being unconditionally and irrevocably guaranteed by Morgan Stanley, substitute a subsidiary of Morgan Stanley in place of the Issuer as principal debtor under the Notes and the Coupons appertaining thereto (if any) or may substitute Morgan Stanley in place of the Issuer.

Any Notes in respect of which such a substitution is effected will be fully and unconditionally guaranteed pursuant to a guarantee of Morgan Stanley as to the payment of principal of, premium, interest and supplemental amounts, if any, and any Additional Amounts on those Notes when and as the same will become due and payable, whether at maturity or otherwise. Under the terms of the guarantee, holders of the Notes will not be required to exercise their remedies against the substitute issuer prior to proceeding directly against Morgan Stanley.

## 29 GOVERNING LAW AND JURISDICTION

- 29.1 *Governing law:* The Notes are governed by, and shall be construed in accordance with, English law.
- 29.2 *Jurisdiction:* Each of Morgan Stanley, Morgan Stanley Jersey and MSBV agrees for the benefit of the Noteholders that the courts of England shall have jurisdiction to hear and determine any suit, action or proceedings, and to settle any disputes, which may arise out of or in connection with the Notes (respectively, "**Proceedings**" and "**Disputes**") and, for such purposes, irrevocably submits to the jurisdiction of such courts.
- 29.3 *Appropriate forum:* Each of Morgan Stanley, Morgan Stanley Jersey and MSBV irrevocably waives any objection which it might now or hereafter have to the courts of England being nominated as the forum to hear and determine any Proceedings and to settle any Disputes, and agrees not to claim that any such court is not a convenient or appropriate forum.
- 29.4 *Process agent:* Each of Morgan Stanley, Morgan Stanley Jersey and MSBV agrees that the process by which any Proceedings in England are begun may be served on it by being delivered to Morgan Stanley & Co. International Limited, 25 Cabot Square, Canary Wharf, London E14 4QA or, if different, its registered office for the time being or at any address of Morgan Stanley

in Great Britain at which process may be served on it in accordance with Part XXIII of the Companies Act 1985. If such Person is not or ceases to be effectively appointed to accept service of process on behalf of any Issuer, such Issuer shall, on the written demand of any Noteholder addressed to the Issuer and delivered to the Issuer or to the Specified Office of the Fiscal Agent, appoint a further Person in England to accept service of process on its behalf and, failing such appointment within 15 days, any Noteholder shall be entitled to appoint such a Person by written notice addressed to the Issuer and delivered to the Issuer or to the Specified Office of the Fiscal Agent. Nothing in this paragraph shall affect the right of any Noteholder to serve process in any other manner permitted by law.

- 29.5 *Non-exclusivity*: The submission to the jurisdiction of the courts of England shall not (and shall not be construed so as to) limit the right of any Noteholder to take Proceedings in any other court of competent jurisdiction, nor shall the taking of Proceedings in any one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction (whether concurrently or not) if and to the extent permitted by law.

### **30 RIGHTS OF THIRD PARTIES**

No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

## PRO FORMA FINAL TERMS FOR THE NEW YORK LAW NOTES

### FINAL TERMS NO. [•]

(To Base Prospectus Dated [•])

**MORGAN STANLEY**  
**NOTES, SERIES [A/B]**  
*[Description of Notes]*

This document constitutes Final Terms relating to the issue of Notes described herein. Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Base Prospectus dated 12 July 2006 [and the supplemental Base Prospectus dated [•]] which [together] constitute[s] a base prospectus (the "**Base Prospectus**") for the purposes of the Prospectus Directive (Directive 2003/71/EC) (the "**Prospectus Directive**"). This document constitutes the Final Terms of the Notes described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with such Base Prospectus [as so supplemented]. Full information on the Issuer and the offer of the Notes is only available on the basis of the combination of these Final Terms and the Base Prospectus. [The Base Prospectus [and the supplemental Base Prospectus] [is] [are] available for viewing at [address] [and] [website] and copies may be obtained from [address].]

We, Morgan Stanley, may not redeem these Notes, Series [A/B] (*Description of Notes*) (the "**Notes**") prior to the maturity date other than under the circumstances described under "Description of New York Law Notes - Tax Redemption" in the accompanying Base Prospectus.

We will issue the Notes only in bearer form, which form is further described under "Forms of Notes" in the accompanying Base Prospectus. You may not exchange Notes in bearer form at any time for Notes in registered form.

We will apply to the [name of stock exchange] for the listing and quotation of the Notes, subject to meeting the applicable listing requirements. The [name of stock exchange] assumes no responsibility for the correctness of any of the statements or opinions made or reports contained in this document. Admission to the official list of and quotation of the Notes on the [name of stock exchange] is not to be taken as an indication of the merits of the issuer or the Notes.

We described the basic feature of this type of Note in the section called "Description of New York Law Notes - [Fixed/Floating] Rate Notes" in the accompanying Base Prospectus, subject to and as modified by the provisions described below.

Principal Amount:	[•]	Annual Redemption percentage Reduction:	[•]
Maturity Date:	[•]	Denomination:	[•]
Settlement Date (original Issue Date):	[•]	Interest Payment Dates:	[•]
Interest Accrual Date:	[•]	Optional Repayment Date(s):	[•]
Issue Price:	[•]	Distribution Agent:	[•]
Specified	[•]	Paying Agent:	[•]

Currency:			
Interest Payment: Period:	[•]	Common Code:	[•]
Interest Rate:	[•]	ISIN:	[•]
Redemption Percentage at Maturity:	[•]	Business Days:	[•]
Initial Redemption Percentage:	[•]	Other Provisions:	[•]
Additional provisions for Floating Rate Notes			
Base Rate:	[•]	Spread (Plus or Minus):	[•]
Spread Multiplier:	[•]	Index Currency:	[•]
Index Maturity:	[•]	Maximum Interest Rate:	[•]
Minimum Interest Rate:	[•]	Initial Interest Rate:	[•]
Interest Reset Dates:	[•]	Interest Determination Dates	[•]
Reporting Service:	[•]		
Additional provisions for Index Linked Notes			
The Index:	[•]	Index Performance:	[•]
Index Value:	[•]	Initial Index Value:	[•]
Adjustment Amount:	[•]	Valuation Date:	[•]
Relevant Exchange:	[•]	Successor Index:	[•]
Trading Day	[•]	Additional Events of Default:	[•]
Market Disruption Event:	[•]	Other Provisions:	[•]
New Global Note Form	Yes/No		

Terms not defined above have the meaning given to those terms in the accompanying Base Prospectus.

**THE NOTES DESCRIBED HEREIN HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT") OR THE SECURITIES LAW OF ANY STATE IN THE UNITED STATES, AND ARE SUBJECT TO U.S. TAX LAW REQUIREMENTS. THE NOTES DESCRIBED HEREIN MAY NOT BE OFFERED, SOLD OR DELIVERED AT ANY TIME, DIRECTLY OR INDIRECTLY, WITHIN THE UNITED STATES OR TO OR FOR THE ACCOUNT OF U.S. PERSONS (AS DEFINED IN EITHER REGULATIONS UNDER THE SECURITIES ACT OR THE UNITED STATES INTERNAL REVENUE CODE OF 1986, AS AMENDED), SEE "SUBSCRIPTION AND SALE" AND "NO OWNERSHIP BY U.S. PERSONS" IN THE ACCOMPANYING BASE PROSPECTUS.**

#### **Taxation**

[•]

#### **Additional Selling Restrictions**

[•]

These Final Terms comprise the final terms required to list and have admitted to trading the issue of Notes described herein pursuant to the Program for the Issuance of Notes, Series A and B of [Morgan Stanley/Morgan Stanley (Jersey) Limited/Morgan Stanley B.V.]

#### **RESPONSIBILITY**

The Issuer [and the Guarantor] accept[s] responsibility for the information contained in these Final Terms. [• has been extracted from •. [Each of the] [The] Issuer [and the Guarantor] confirms that such information has been accurately reproduced and that, so far as it is aware, and is able to ascertain from information published by •, no facts have been omitted which would render the reproduced inaccurate or misleading. ]

Signed on behalf of the Issuer:

By: .....  
Duly authorised

[Signed on behalf of the Guarantor:

By: .....  
Duly authorised]

### **PART B – OTHER INFORMATION**

#### **1. LISTING**

Listing: [London/ other (specify)/None]

Admission to trading: [Application has been made for the Notes to be admitted to trading on [ ] with effect from [ ].] [Not Applicable.]

(Where documenting a fungible issue need to indicate that original

securities are already admitted to trading.)

[Estimate of total [ ]]<sup>1</sup>  
expenses related to  
admission to trading:

## 2. RATINGS

Ratings: The Notes to be issued have been rated:

[S & P: [ ]]

[Moody's: [ ]]

[[Other]: [ ]]

[Need to include a brief explanation of the meaning of the ratings if this has previously been published by the rating provider.]<sup>2</sup>

(The above disclosure should reflect the rating allocated to Notes of the type being issued under the Program generally or, where the issue has been specifically rated, that rating.)

## 3. [NOTIFICATION]

The [include name of competent authority in home Member State] [has been requested to provide/has provided - include first alternative for an issue which is contemporaneous with the establishment or update of the Program and the second alternative for subsequent issues] the [include names of competent authorities of host Member States] with a certificate of approval attesting that the Base Prospectus has been drawn up in accordance with the Prospectus Directive.]

## 4. [INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE [ISSUE/OFFER]]

Need to include a description of any interest, including conflicting ones, that is material to the issue/offer, detailing the persons involved and the nature of the interest. May be satisfied by the inclusion of the following statement:

"Save as discussed in ["Subscription and Sale"], so far as the Issuer is aware, no person involved in the offer of the Notes has an interest material to the offer."

## 5 REASONS FOR THE OFFER, ESTIMATED NET PROCEEDS AND TOTAL EXPENSES

[(i) Reasons for the [ ]  
offer

(If reasons for offer different from making profit and/or hedging certain risks will need to include those reasons here.)]

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<sup>1</sup> Delete for Notes with a denomination per Note of less than EUR50,000

<sup>2</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

[(ii)] Estimated net •  
proceeds:

(If proceeds are intended for more than one use will need to split out and present in order of priority. If proceeds insufficient to fund all proposed uses state amount and sources of other funding.)

[(iii)] Estimated total • [Include breakdown of expenses.]  
expenses:

(If the Notes are derivative securities to which Annex XII of the Prospectus Directive Regulation applies it is only necessary to include disclosure of net proceeds and total expenses at (ii) and (iii) above where disclosure is included at (i) above.)

## 6. [Fixed Rate Notes only – YIELD

Indication of yield: •

[Calculated as [include details of method of calculation in summary form] on the Issue Date.

As set out above,]<sup>3</sup> the yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.]

## 7. [[Floating Rate Notes only - HISTORIC INTEREST RATES

Details of historic [LIBOR/EURIBOR/other] rates can be obtained from [Telerate].] <sup>4</sup>

## 8. [Index-Linked or other variable-linked Notes only – PERFORMANCE OF INDEX/FORMULA/OTHER VARIABLE, [EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS] <sup>5</sup> AND OTHER INFORMATION CONCERNING THE UNDERLYING

*Need to include details of where past and future performance and volatility of the index/formula/other variable can be obtained [and a clear and comprehensive explanation of how the value of the investment is affected by the underlying and the circumstances when the risks are most evident]<sup>6</sup>. [Where the underlying is an index need to include the name of the index and a description if composed by the Issuer and if the index is not composed by the Issuer need to include details of where the information about the index can be obtained. Where the underlying is not an index need to include equivalent information. ]*

## 9. [Dual Currency Notes only – PERFORMANCE OF RATE[S] OF EXCHANGE [AND EXPLANATION OF EFFECT ON VALUE OF INVESTMENT]<sup>7</sup>

Need to include details of where past and future performance and volatility of the relevant rate[s] can be obtained [and a clear and comprehensive explanation of how the value of the investment is affected by the underlying and the circumstances when the risks are most evident.]]<sup>8</sup>

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<sup>3</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>4</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>5</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>6</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>7</sup> Delete for Notes with a denomination per Note of EUR50,000 or more



## 10. OPERATIONAL INFORMATION

ISIN Code: [   ]

Common Code: [   ]

New Global Note Yes/No

Any clearing system(s) other than Euroclear Bank S.A./N.V. and Clearstream and the relevant identification number(s): [Not Applicable/give name(s) and number(s)]

Delivery: Delivery [against/free of] payment

Names and addresses of additional Paying Agent(s) (if any): [   ]

Intended to be held in a manner which would allow Eurosystem eligibility: [Yes][No]

[Note that designation "yes" simply means that the Notes are intended upon issue to be deposited with one of the ICSDs as common safekeeper and does not necessarily mean that the Notes will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either on issue or subsequently. Such recognition will depend on satisfaction of Eurosystem eligibility criteria][include this text if "yes" selected, in which case the Notes must be issued in NGN form]

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<sup>8</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

## PRO FORMA FINAL TERMS FOR THE ENGLISH LAW NOTES

Final Terms dated [•]

[Name of Issuer]

Issue of [Aggregate Nominal Amount of Tranche] [Title of Notes]

[Guaranteed by Morgan Stanley]

under the Program for the Issuance of Notes, Series A and B,

### PART A – CONTRACTUAL TERMS

THE NOTES DESCRIBED HEREIN HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR THE SECURITIES LAWS OF ANY STATE IN THE UNITED STATES, AND ARE SUBJECT TO U.S. TAX LAW REQUIREMENTS. THE NOTES DESCRIBED HEREIN MAY NOT BE OFFERED, SOLD OR DELIVERED AT ANY TIME, DIRECTLY OR INDIRECTLY, WITHIN THE UNITED STATES OR TO OR FOR THE ACCOUNT OR BENEFIT OF U.S. PERSONS (AS DEFINED IN EITHER REGULATION S UNDER THE SECURITIES ACT OR THE UNITED STATES INTERNAL REVENUE CODE OF 1986, AS AMENDED). SEE "SUBSCRIPTION AND SALE" AND "NO OWNERSHIP BY U.S. PERSONS" IN THE BASE PROSPECTUS DATED 12 JULY 2006. IN PURCHASING THE NOTES, PURCHASERS WILL BE DEEMED TO REPRESENT AND WARRANT THAT THEY ARE NEITHER LOCATED IN THE UNITED STATES NOR A U.S. PERSON AND THAT THEY ARE NOT PURCHASING FOR, OR FOR THE ACCOUNT OR BENEFIT OF, ANY SUCH PERSON. THE NOTES ARE NOT RATED.

This document constitutes Final Terms relating to the issue of Notes described herein. Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Base Prospectus dated 12 July 2006 [and the supplemental Base Prospectus dated [•]] which [together] constitute[s] a base prospectus (the "**Base Prospectus**") for the purposes of the Prospectus Directive (Directive 2003/71/EC) (the "**Prospectus Directive**"). This document constitutes the Final Terms of the Notes described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with such Base Prospectus [as so supplemented]. Full information on the Issuer and the offer of the Notes is only available on the basis of the combination of these Final Terms and the Base Prospectus. Copies of the Base Prospectus are available from the offices of Morgan Stanley & Co. International Limited at 25 Cabot Square, Canary Wharf, London E14 4QA.

#### Information Concerning Investment Risk

[ ]

*The following alternative language applies if the first tranche of an issue which is being increased was issued under a Base Prospectus with an earlier date.*

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions (the "**Conditions**") set forth in the Base Prospectus dated [original date] [and the supplemental Base Prospectus dated [•]]. This document constitutes the Final Terms of the Notes described herein for the purposes of Article 5.4 of the Prospectus Directive (Directive 2003/71/EC) (the "**Prospectus Directive**") and must be read in conjunction with the Base Prospectus dated [current date] [and the supplemental Base Prospectus dated [•]], which [together] constitute[s] a base prospectus for the purposes of the Prospectus Directive, save in respect of the Conditions which are extracted from the Base Prospectus dated [original date] [and

*[Include whichever of the following apply or specify as "Not Applicable" (N/A). Note that the numbering should remain as set out below, even if "Not Applicable" is indicated for individual paragraphs or subparagraphs. Italics denote guidance for completing the Final Terms.]*

- 155

- [Index Linked Interest]
- [Other (specify)]
- (further particulars specified below)
10. Redemption/Payment Basis: [Redemption at par]
- [Index Linked Redemption]
- [Dual Currency]
- [Partly Paid]
- [Instalment]
- [Equity Linked Redemption]
- [Commodity Linked Redemption]
- [Credit Linked Redemption]
- [Other (specify)]
11. Change of Interest or Redemption/Payment Basis: [Specify details of any provision for convertibility of Notes into another interest or redemption/ payment basis]
12. Put/Call Options:
- (i) Redemption at the option of the Noteholders: [Applicable/Not Applicable]  
(Condition 13.7)
- (ii) Redemption at the option of the Noteholders: [Applicable/Not Applicable]  
(Condition 13.9)
- (iii) Other Put/Call Options: [Applicable/Not applicable]
- 13 [(i)] Status of the Notes: [Senior/[Dated/Perpetual]/ Subordinated]  
(Condition 4)
- [(ii)] Status of the Guarantee: [Senior/[Dated/Perpetual]/Subordinated]]
- [(iii)] [Date [Board] approval for issuance of Notes [and Guarantee] obtained: [ ] [and [ ]], respectively]]  
(N.B Only relevant where Board (or similar) authorisation is required for the particular tranche of Notes or related Guarantee))
14. Method of distribution: [Syndicated/Non-syndicated]

**PROVISIONS RELATING TO  
INTEREST (IF ANY) PAYABLE**

15. **Fixed Rate Note Provisions** [Applicable/Not Applicable]  
(If not applicable, delete the remaining sub-

(Condition 5)		<i>paragraphs of this paragraph)</i>
(i)	Rate[(s)] of Interest:	[ ] per cent. per annum [payable [annually/semi-annually/quarterly/monthly] in arrear]
(ii)	Interest Payment Date(s):	[ ] in each year [adjusted in accordance with <i>[specify Business Day Convention and any applicable Business Centre(s) for the definition of "Business Day"]</i> /not adjusted]
(iii)	Fixed Coupon Amount[(s)]:	[ ] per [ ] in Nominal Amount
(iv)	Broken Amount(s):	<i>[Insert particulars of any initial or final broken interest amounts which do not correspond with the Fixed Coupon Amount[(s)]]</i>
(v)	Day Count Fraction:	[Actual/365, Actual/Actual; Actual/365(Fixed); Actual/360; 30/360; 30E/360, Eurobond Basis; Actual/ISMA; other]
(vi)	Other terms relating to the method of calculating interest for Fixed Rate Notes:	[Not Applicable/ <i>give details</i> ]
16.	<b>Floating Rate Note Provisions</b>	[Applicable/Not Applicable]
(Condition 6)		<i>(If not applicable, delete the remaining sub- paragraphs of this paragraph)</i>
(i)	Specified Interest Payment Dates:	[ ]
(ii)	Business Day Convention:	[Floating Rate Convention/ Following Business Day Convention/ Modified Following Business Day Convention/ Preceding Business Day Convention/ other ( <i>give details</i> )]
(iii)	Additional Business Centre(s):	[ ]
(iv)	Manner in which the Rate(s) of Interest is/are to be determined:	[Screen Rate Determination/ISDA Determination/other ( <i>give details</i> )]
(v)	Party responsible for calculating the Rate(s) of Interest and Interest Amount(s) (if not the Calculation Agent):	[ ]
(vi)	Screen Rate Determination:	

- Reference Rate: [   ]
  - Interest Determination Date(s): [   ]
  - Relevant Screen Page: [   ]
  - (vii) ISDA Determination
    - Floating Rate Option: [   ]
    - Designated Maturity: [   ]
    - Reset Date: [   ]
  - (viii) Margin(s): [ +/ - ] [   ] per cent per annum
  - (ix) Minimum Rate of Interest: [   ] per cent per annum
  - (x) Maximum Rate of Interest: [   ] per cent per annum
  - (xi) Day Count Fraction: [   ]
  - (xii) Fall back provisions, rounding provisions, denominator and any other terms relating to the method of calculating interest on Floating Rate Notes, if different from those set out in the Conditions: [   ]
17. **Index-Linked Interest Note/other variable-linked interest Note Provisions** [Applicable/Not Applicable]
- (If not applicable, delete the remaining sub-paragraphs of this paragraph)*
- (Condition 6)
- (i) Index/Formula/other variable: [give or annex details]
  - (ii) Calculation Agent responsible for calculating the interest due: [   ]
  - (iii) Provisions for determining Coupon where calculated by reference to Index and/or Formula and/or other variable:
  - (iv) Determination Date(s): [   ]
  - (v) Provisions for determining Coupon where calculation by reference to Index and/or Formula and/or other variable *(Need to include a description of market disruption or settlement disruption events and*

- is impossible or impracticable *adjustment provisions*  
or otherwise disrupted:
- (vi) Interest or calculation periods(s): [ ]
  - (vii) Specified Interest Payment Dates: [ ]
  - (viii) Business Day Convention: [Floating Rate Convention/ Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/other *(give details)*]
  - (ix) Business Centre(s): [ ]
  - (x) Minimum Rate/Amount of Interest: [ ] per cent per annum
  - (xi) Maximum Rate/Amount of Interest: [ ] per cent per annum
  - (xii) Day Count Fraction: [ ]
18. **Zero Coupon Note Provisions** [Applicable/Not Applicable]
- (Condition 7) *(If not applicable, delete the remaining sub-paragraphs of this paragraph)*
- (i) [Amortisation/Accrual] Yield: [ ] per cent per annum
  - (ii) Reference Price: [ ]
  - (iii) Any other formula/basis of determining amount payable: [ ]
19. **Dual Currency Note Provisions** [Applicable/Not Applicable]
- (Condition 8) **(If not applicable, delete the remaining sub-paragraphs of this paragraph)**
- (i) Rate of Exchange/method of calculating Rate of Exchange: [give details]
  - (ii) Calculation Agent, if any, responsible for calculating the principal and/or interest due: [ ]
  - (iii) Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable: [Need to include a description of market disruption or settlement disruption events and adjustment provisions.]

- (iv) Person at whose option Specified [     ]  
Currency(ies) is/are payable:
- (v) Other special terms
20. **Equity Linked Note provisions;**  
(Condition 10);
- (A) (i) **Single Share Notes, Share Basket Notes:** *(if not applicable, delete sub-paragraph (A))*
- (ii) Whether the Notes relate to a [Single Share]  
single share or a basket of [Basket of Shares]  
shares (each an "Underlying  
Share") and the identity of the  
relevant issuer(s) and class of  
the Underlying Share (each  
an "Underlying Issuer"):
- (iii) Whether redemption of the [Cash Settlement/Physical Settlement]  
Notes will be by (a) Cash  
Settlement or (b) Physical  
Settlement or (c) in certain  
circumstances depending on  
the closing price of the  
Underlying Shares, Cash  
Settlement or Physical  
Delivery at the option of the  
Issuer: [In the event of *(describe triggers linked to the  
closing price of the Underlying Shares)*, Cash  
Settlement or Physical Settlement at the option  
of the Issuer]
- (iv) Exchange[s]: [     ]
- (v) Related Exchange[s]: [     ][None specified]
- (vi) Weighting for each [Insert details] [N/A]  
Underlying Share comprising  
the basket:
- (vii) Delivery provisions for [     ] *(only where Physical Settlement is  
Underlying Shares (including  
details of who is to make such  
delivery): applicable)*
- (viii) Physical Settlement: [Applicable / Not Applicable]
- (ix) Additional Disruption Events Change in Law, Hedging Disruption, Loss of  
Stock Borrow and Increased Cost of Hedging  
shall apply [*specify if any are not applicable, or  
any further Additional Disruption Events*]
- (x) Other terms or special [     ]  
conditions
- (B) **Index/Index Basket Notes:** *(If not applicable, delete sub-paragraph (B))*



21	(i)	Types of Notes:	Index Notes (specify Index if applicable)
			Index Basket Notes (specify Indices if applicable)
	(i)	Exchange[s]:	[specify Exchange, or “Multi-exchange Index”, in relation to each Index]
	(ii)	Related Exchanges[s]:	[ ] [None specified]
	(iii)	Weighting for each Index:	[insert details] [Not Applicable]
	(iv)	Other terms or special conditions:	[ ]
	<b>Commodity Notes</b>		[Applicable] [Not Applicable]  (if not applicable, delete the remaining sub- paragraphs of this paragraph)
	(i)	Commodity/ies or Commodity Index/Indices:	[ ] [if applicable, specify whether Non Metal, Base Metal or Precious Metal]
	(ii)	Commodity Reference Price:	[specify Commodity Reference Price]
	(iii)	Exchange	[specify for each Commodity]
	(iv)	Price Source	[specify for each Commodity]
	(iv)	Specified Price:	[[high][low][average of high and low][closing price][opening price][bid] [asked] [average of high and low prices][settlement price][official settlement price][official price][morning fixing][afternoon fixing][spot price][Other (specify)]  (if appropriate, specify time as of which the price will be determined)
	(v)	Delivery Date:	[ ] (specify whether price based on spot market, First Nearby Month, Second Nearby Month, etc.)
	(vi)	Pricing Date:	[ ]
	(vii)	Common Pricing:	[Applicable] [Not Applicable] (include only if Basket of Commodities)
	(vii)	Commodity Disruption	[Price Source Disruption]

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	Events:	[Trading Disruption] [Disappearance of Commodity Reference Price] [Material Change in Formula] [Material Change in Content] [Tax Disruption] [Trading Limitation] [specify any applicable additional Commodity Disruption Events][Not Applicable]
	Commodity Disruption Fallback:	[Determination Agent Determination as defined in Condition 11.3][Other]
(viii)	Other Terms and Conditions:	[    ]
22.	<b>Currency Notes</b>	[Applicable] [Not Applicable]  <i>(if not applicable, delete the remaining sub-paragraphs of this paragraph)</i>
(i)	Settlement Currency:	[    ]
(ii)	Reference Currency:	[    ]
	Specified Amount:	[    ]
	Reference Currency Jurisdiction:	[    ]
(iii)	Specified Rate:	<i>Specify one of:</i>  Reference Currency bid exchange rate; Reference Currency offer exchange rate; Average of Reference Currency bid and offer exchange rates; Settlement Currency bid exchange rate; Settlement Currency offer exchange rate; Average of Settlement Currency bid and offer exchange rates; Official fixing rate;  Other
(iv)	Settlement Rate Option:	[Currency Reference Dealers]
(v)	Valuation Date:	[    ]
(vi)	Averaging Dates:	[    ][Not Applicable]
(vii)	Currency Disruption Events:	Price Source Disruption [Applicable/Not Applicable]  [Other]

	Currency Disruption Fallbacks:	Determination Agent Determination of Settlement Rate;  Fallback Reference Price;  Other  <i>(where applicable, specify which Currency Disruption Fallback applies to which Currency Disruption Event, and if more than one Currency Disruption Fallback may apply to a Currency Disruption Event, the order in which such Currency Disruption Fallbacks will apply)</i>
	(viii) Other special terms and conditions:	[    ]
23.	<b>Credit-Linked Note provisions</b>	[Applicable/ Not Applicable] <i>(if applicable, insert relevant provisions)</i>
<b>PROVISIONS RELATING TO REDEMPTION</b>		
24.	<b>Call Option</b>	[Applicable/Not Applicable]
	(Condition 13.7)	<i>(If not applicable, delete the remaining sub-paragraphs of this paragraph)</i>
	(i) Optional Redemption Date(s):	[    ]
	(ii) Optional Redemption Amount(s) of each Note and method, if any, of calculation of such amount(s):	[    ] per Note of [    ] specified denomination
	(iii) If redeemable in part:	[    ]
	(a) Minimum Redemption Amount:	
	(b) Maximum Redemption Amount	[    ]
	(iv) Notice period:	[    ]
25.	<b>Put Option</b>	[Applicable/Not Applicable]
	(Condition 13.9)	<i>(If not applicable, delete the remaining sub-paragraphs of this paragraph)</i>
	(i) Optional Redemption Date(s):	[    ]
	(ii) Optional Redemption Amount(s) of each Note and method, if any, of calculation of such amount(s):	[    ] per Note of [    ] specified denomination

- (iii) Notice period [ ]
26. **Final Redemption Amount of each Note** [[ ] per Note of [ ] specified denomination /other/see Appendix]
- (Condition 13.1)
- (i) Underlying asset/ index: [ ]
- (ii) Determination Agent responsible for calculating the Final Redemption Amount: [ ]
- (iii) Provisions for determining Final Redemption Amount: [ ]
- (iv) Determination Date: [ ]
- (v) Determination Time: [ ] [As specified in the Conditions]
- (vi) Observation Dates: [Applicable/Not Applicable]
- (vii) Averaging Dates: [Applicable/Not Applicable]
- [if Applicable, specify consequences of Averaging Date Disruption as Omission, Postponement or Modified Postponement]
- (viii) Provisions for determining Final Redemption Amount where calculation by reference to Index and/or Formula and/or other variable is impossible or impracticable or otherwise disrupted: [ ]
- (ix) Payment Date: [ ]
- (x) Minimum Final Redemption Amount: [ ]
- (xi) Maximum Final Redemption Amount: [ ]
27. **Early Termination Amount and Redemption Amount upon early redemption**
- (Condition 13.2, 13.5, 13.10, 13.11 and 17)
- Early Redemption Amount(s) of [ ] each Note payable on redemption for taxation reasons or on event of default or other early redemption and/or the method of calculating the

same (if required or if different from that set out in the Conditions):

28. Governing Law: [English law/other]

# **GENERAL PROVISIONS APPLICABLE TO THE NOTES**

29. Form of Notes: (Condition 3) Bearer Notes:
- [Temporary Global Note exchangeable for a Permanent Global Note which is exchangeable for Definitive Notes on [ ] days' notice/at any time/in the limited circumstances specified in the Permanent Global Note]
- [Temporary Global Note exchangeable for Definitive Notes on [ ] days' notice]
- [Permanent Global Note exchangeable for Definitive Notes on [ ] days' notice/at any time/in the limited circumstances specified in the Permanent Global Note]
30. Additional Financial Centre(s) or other special provisions relating to Payment Dates: [Not Applicable/give details. *Note that this item relates to the date and place of payment, and not interest period end dates, to which items 15 (ii), 16(iv) and 17(i) relates*]
31. Talons for future Coupons or Receipts to be attached to Definitive Notes (and dates on which such Talons mature): [Yes/No. *If yes, give details*]
32. Details relating to Partly Paid Notes: amount of each payment comprising the Issue Price and date on which each payment is to be made and consequences (if any) of failure to pay, including any right of the Issuer to forfeit the Notes and interest due on late payment: [Not Applicable/give details]
33. Details relating to Instalment Notes: amount of each instalment, date on which each payment is to be made: [Not Applicable/give details]
34. Redenomination, renominatisation and reconventioning provisions: [Not Applicable/The provisions [in Condition •] [annexed to these Final Terms] apply]
35. Consolidation provisions: [Not Applicable/The provisions [in Condition •] [annexed to these Final Terms] apply]

36. Other final terms: [Not Applicable/give details]
- (When adding any other final terms consideration should be given as to whether such terms constitute a "significant new factor" and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive)*

## DISTRIBUTION

37. (i) If syndicated, names [and addresses]<sup>10</sup> of Managers [and underwriting commitments]<sup>11</sup>; and names and addresses of the entities agreeing to place the issue without a firm commitment or on a "best efforts" basis if such entities are not the same as the Managers.}]<sup>12</sup> [Not Applicable/give names[, addresses and underwriting commitments]<sup>13</sup> [(Include names and addresses of entities agreeing to underwrite the issue on a firm commitment basis
- (ii) [Date of [Subscription] Agreement: [ ]]<sup>14</sup>
- (iii) Stabilising Manager(s) (if any): [Not Applicable/give name]
38. If non-syndicated, name [and address]<sup>8</sup> of Dealer: [Not Applicable/give name [and address]<sup>15</sup>]
39. Whether TEFRA D or TEFRA C rules applicable or TEFRA rules applicable: [ ]
40. [Total commission and concession: [ ] per cent. of the Aggregate Nominal Amount]<sup>16</sup>
41. Additional selling restrictions: [Not Applicable/give details]

## [LISTING AND ADMISSION TO TRADING APPLICATION

<sup>10</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>11</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>12</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>13</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>14</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>15</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>16</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

These Final Terms comprise the final terms required to list and have admitted to trading the issue of Notes described herein pursuant to the Program for the Issuance of Notes, Series A and B of [Morgan Stanley/Morgan Stanley (Jersey) Limited/Morgan Stanley B.V.]

## RESPONSIBILITY

The Issuer [and the Guarantor] accept[s] responsibility for the information contained in these Final Terms. [● has been extracted from ●. [Each of the] [The] Issuer [and the Guarantor] confirms that such information has been accurately reproduced and that, so far as it is aware, and is able to ascertain from information published by ●, no facts have been omitted which would render the reproduced inaccurate or misleading. ]

Signed on behalf of the Issuer:

By: .....  
Duly authorised

[Signed on behalf of the Guarantor:

By: .....  
Duly authorised]



## PART B – OTHER INFORMATION

### 1. LISTING

Listing: [London/ other (specify)/None]

Admission to trading: [Application has been made for the Notes to be admitted to trading on [ ] with effect from [ ].] [Not Applicable.]

(Where documenting a fungible issue need to indicate that original securities are already admitted to trading.)

[Estimate of total [ ]]17  
expenses related to  
admission to trading:

### 2. RATINGS

Ratings: The Notes to be issued have been rated:

[S & P: [ ]]

[Moody's: [ ]]

[[Other]: [ ]]

[Need to include a brief explanation of the meaning of the ratings if this has previously been published by the rating provider.]18

(The above disclosure should reflect the rating allocated to Notes of the type being issued under the Program generally or, where the issue has been specifically rated, that rating.)

### 3. [NOTIFICATION

The [include name of competent authority in home Member State] [has been requested to provide/has provided - include first alternative for an issue which is contemporaneous with the establishment or update of the Program and the second alternative for subsequent issues] the [include names of competent authorities of host Member States] with a certificate of approval attesting that the Base Prospectus has been drawn up in accordance with the Prospectus Directive.]

### 4. [INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE [ISSUE/OFFER]

Need to include a description of any interest, including conflicting ones, that is material to the issue/offer, detailing the persons involved and the nature of the interest. May be satisfied by the inclusion of the following statement:

"Save as discussed in ["Subscription and Sale"], so far as the Issuer is aware, no person involved in the offer of the Notes has an interest material to the offer."

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<sup>17</sup> Delete for Notes with a denomination per Note of less than EUR50,000

<sup>18</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

## 5 REASONS FOR THE OFFER, ESTIMATED NET PROCEEDS AND TOTAL EXPENSES

[(i) Reasons for the [ ] offer

(If reasons for offer different from making profit and/or hedging certain risks will need to include those reasons here.)]

[(ii)] Estimated net • proceeds:

(If proceeds are intended for more than one use will need to split out and present in order of priority. If proceeds insufficient to fund all proposed uses state amount and sources of other funding.)

[(iii)] Estimated total • expenses: [Include breakdown of expenses.]

(If the Notes are derivative securities to which Annex XII of the Prospectus Directive Regulation applies it is only necessary to include disclosure of net proceeds and total expenses at (ii) and (iii) above where disclosure is included at (i) above.)

## 6. [Fixed Rate Notes only – YIELD

Indication of yield: •

[Calculated as [include details of method of calculation in summary form] on the Issue Date.

As set out above,]<sup>19</sup> the yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.]

## 7. [[Floating Rate Notes only - HISTORIC INTEREST RATES

Details of historic [LIBOR/EURIBOR/other] rates can be obtained from [Telerate].] <sup>20</sup>

## 8. [Index-Linked or other variable-linked Notes only – PERFORMANCE OF INDEX/FORMULA/OTHER VARIABLE, [EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS] <sup>21</sup> AND OTHER INFORMATION CONCERNING THE UNDERLYING

*Need to include details of where past and future performance and volatility of the index/formula/other variable can be obtained [and a clear and comprehensive explanation of how the value of the investment is affected by the underlying and the circumstances when the risks are most evident]<sup>22</sup>. [Where the underlying is an index need to include the name of the index and a description if composed by the Issuer and if the index is not composed by the Issuer need to include details of where the information about the index can be obtained. Where the underlying is not an index need to include equivalent information. ]*

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<sup>19</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>20</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>21</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>22</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

**9. [Dual Currency Notes only – PERFORMANCE OF RATE[S] OF EXCHANGE [AND EXPLANATION OF EFFECT ON VALUE OF INVESTMENT]]<sup>23</sup>**

Need to include details of where past and future performance and volatility of the relevant rate[s] can be obtained [and a clear and comprehensive explanation of how the value of the investment is affected by the underlying and the circumstances when the risks are most evident.]]<sup>24</sup>

**10. OPERATIONAL INFORMATION**

ISIN Code: [ ]

Common Code: [ ]

New Global Note Yes/No

Any clearing system(s) [Not Applicable/give name(s) and number(s)]  
other than Euroclear  
Bank S.A./N.V. and  
Clearstream and the  
relevant identification  
number(s):

Delivery: Delivery [against/free of] payment

Names and addresses [ ]  
of additional Paying  
Agent(s) (if any):

Intended to be held in [Yes][No]  
a manner which would  
allow Eurosystem  
eligibility:

[Note that designation "yes" simply means that the Notes are intended upon issue to be deposited with one of the ICSDs as common safekeeper and does not necessarily mean that the Notes will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either on issue or subsequently. Such recognition will depend on satisfaction of Eurosystem eligibility criteria][include this text if "yes" selected, in which case the Notes must be issued in NGN form]

<sup>23</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

<sup>24</sup> Delete for Notes with a denomination per Note of EUR50,000 or more

## FORMS OF NOTES

Unless otherwise specified in the applicable Final Terms, each issuance of Notes having a maturity of more than 183 days (and any Tranche thereof) will initially be in the form of a temporary global note (a "**Temporary Global Note**"), without interest coupons. Each Temporary Global Note will be deposited on or around the issue date of such Notes (or any Tranche thereof) either;

- (a) if the Temporary Global Note is intended to be issued in New Global Note ("**NGN**") form, as stated in the applicable Final Terms, with a common safekeeper (the "**Common Safekeeper**") for Euroclear and/or Clearstream, Luxembourg; and
- (b) if the Temporary Global Note is not intended to be issued in NGN form, with a depositary or a common depositary (together with a "**Common Safekeeper**", "a "**Bearer Note Depositary**") for Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system.

Upon deposit of each Temporary Global Note, Euroclear or Clearstream, Luxembourg or, as applicable, any other relevant clearing system, will credit each subscriber with a principal amount of Notes equal to the principal amount for which it has subscribed and paid.

The interests of the beneficial owner or owners in a Temporary Global Note will be exchangeable, in whole or in part, for interests in a permanent global note (a "**Permanent Global Note**" and, together with a Temporary Global Note, the "**Global Notes**"), without interest coupons, to be held by a Bearer Note Depositary after the date (the "**Exchange Date**") that is 40 days after the date on which the relevant Issuer receives the proceeds of the sale of that Note (or the relevant Tranche thereof) (the "**Closing Date**") only upon certification as to non-U.S. beneficial ownership. The Exchange Date for any Note held by a Distribution Agent as part of an unsold allotment or subscription more than 40 days after the Closing Date for that Note will be the day after the date that Note is sold by that Distribution Agent. However, that exchange will be made only upon receipt of Ownership Certificates (as defined below). No payments will be made under the Temporary Global Note unless exchange for interests in the Permanent Global Note is improperly withheld or refused. In addition, interest payments in respect of the Notes cannot be collected without such certification of non-U.S. beneficial ownership. Each issuance of Notes having a maturity of 183 days or less will be in the form of a Permanent Global Note.

Whenever any interest in the Temporary Global Note is to be exchanged for an interest in a Permanent Global Note, the relevant Issuer shall procure (in the case of the first exchange) the prompt delivery (free of charge to the bearer) of such Permanent Global Note, duly authenticated, to the bearer of the Temporary Global Note or (in the case of any subsequent exchange) an increase in the principal amount of the Permanent Global Note in accordance with its terms against:

- (a) presentation and (in the case of final exchange) surrender of the Temporary Global Note at the Specified Office of the Principal Paying Agent (in the case of New York Law Notes) or the Fiscal Agent (in the case of English Law Notes); and
- (b) receipt by the Principal Paying Agent (in the case of New York Law Notes) or the Fiscal Agent (in the case of English Law Notes) of a certificate or certificates of non-U.S. beneficial ownership,

within seven days of the bearer requesting such exchange.

The principal amount of the Permanent Global Note shall be equal to the aggregate of the principal amounts specified in the certificates of non-U.S. beneficial ownership; *provided, however*, that in no circumstances shall the principal amount of the Permanent Global Note exceed the initial principal amount of the Temporary Global Note.

The Permanent Global Note will be exchangeable in whole, but not in part, for Notes in definitive form ("**Definitive Notes**"), which will be serially numbered, with coupons, if any, attached:

- (a) in the case of Notes issued by Morgan Stanley, if a beneficial owner gives 30 days' written notice to the Principal Paying Agent (in the case of New York Law Notes) or the Fiscal Agent (in the

case of English Law Notes) through either Euroclear or Clearstream, Luxembourg or, as applicable, any other relevant clearing system; upon receipt of an initial request to exchange an interest in a Permanent Global Note for Definitive Notes, all other interests in that Permanent Global Note will be exchanged for Definitive Notes; or

- (b) in the case of Notes issued by Morgan Stanley, Morgan Stanley Jersey, MSBV or an Additional Issuer, if (a) Euroclear or Clearstream, Luxembourg or any other relevant clearing system is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or (b) any Note is accelerated following any of the circumstances described in "Description of the New York Law Notes—Events of Default" or in Condition 18 (Events of Default) of "Terms and Conditions of the English Law Notes".

Whenever the Permanent Global Note is to be exchanged for Definitive Notes, the relevant Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Notes, duly authenticated and with Coupons (as defined in "Terms and Conditions of the English Law Notes" below) and Talons attached (if so specified in the applicable Final Terms), in an aggregate principal amount equal to the principal amount of the Permanent Global Note to the bearer of the Permanent Global Note against the surrender of the Permanent Global Note at the Specified Office of the Principal Paying Agent (in the case of New York Law Notes) or the Fiscal Agent (in the case of English Law Notes) within 30 days of the bearer requesting such exchange. The Bearer Note Depositary for Euroclear and Clearstream, Luxembourg or, as applicable, any other relevant clearing system will instruct the Principal Paying Agent for the Notes (in the case of New York Law Notes) or the Fiscal Agent (in the case of English Law Notes) regarding the aggregate principal amount and denominations of Definitive Notes that must be authenticated and delivered to each of Euroclear and Clearstream, Luxembourg or, as applicable, any other relevant clearing system. Definitive Notes may not be delivered in the United States. Definitive Notes will be serially numbered.

### **Terms and Conditions Applicable to the Notes**

The terms and conditions applicable to any Definitive Note that is a New York Law Note will be set forth in such Definitive Note. The terms and conditions of any Definitive Note that is an English Law Note will be endorsed on that Definitive Note and will consist of the terms and conditions set out under "Terms and Conditions of the English Law Notes" as set out below (or in the relevant Supplemental Base Prospectus) and the provisions of the applicable Final Terms, which supplement, amend and/or replace those terms and conditions.

The terms and conditions applicable to any English Law Note in global form will differ from those terms and conditions which would apply to the English Law Note were it in definitive form to the extent described under "Summary of Provisions Relating to the English Law Notes while in Global Form" below.

### **Legend Concerning United States Persons**

In the case of Notes (or any Tranche thereof) having a maturity of more than 183 days, the Global Notes, the Definitive Notes and any Coupons and Talons appertaining thereto will bear a legend to the following effect:

"Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code."

The sections referred to in such legend provide that a United States person who holds a Note, Coupon or Talon will generally not be allowed to deduct any loss realized on the sale, exchange or redemption of such Note, Coupon or Talon and any gain (which might otherwise be characterized as capital gain) recognized on such sale, exchange or redemption will be treated as ordinary income.

Any Notes (or any Tranche thereof) having a maturity of 183 days or less must have a minimum face and principal amount of \$500,000 and bear the following legend:

"By accepting this obligation, the holder represents and warrants that it is not a United States person (other than an exempt recipient described in Section 6049(b)(4) of the Internal Revenue Code and regulations thereunder) and that it is not acting for or on behalf of a United States person (other than an exempt recipient described in Section 6049(b)(4) of the Internal Revenue Code and regulations thereunder)."

#### **Limitations on Issuance of Bearer Notes**

In compliance with United States federal income tax laws and regulations, bearer notes, including bearer notes in global form, will not be offered, sold or delivered, directly or indirectly, in the United States or its possessions or to United States persons, as defined below, except as otherwise permitted by United States Treasury Regulations Section 1.163-5(c)(2)(i)(D). Any underwriters, agents or dealers participating in the offerings of bearer notes, directly or indirectly, must agree that (i) they will not, in connection with the original issuance of any bearer notes or during the restricted period with respect to such bearer notes (as defined in United States Treasury Regulations Section 1.163-5(c)(2)(i)(D)(7)) (the "**Restricted Period**"), offer, sell or deliver, directly or indirectly, any bearer notes in the United States or its possessions or to United States persons, other than as permitted by the applicable Treasury Regulations described above; and (ii) they will not, at any time offer, sell or deliver, directly or indirectly, any bearer notes in the United States or its possessions or to United States persons, other than as permitted by the applicable Treasury Regulations above.

In addition, any underwriter, agent or dealer must have procedures reasonably designed to ensure that its employees or agents who are directly engaged in selling bearer notes are aware of the above restrictions on the offering, sale or delivery of bearer notes.

Bearer notes, other than bearer notes that satisfy the requirements of United States Treasury Regulations Section 1.163-5(c)(2)(i)(D)(3)(iii) and any coupons or talons appertaining thereto, will not be delivered in definitive form, and no interest will be paid thereon, unless the relevant Issuer has received a signed certificate in writing, or an electronic certificate described in United States Treasury Regulations Section 1.163-5(c)(2)(i)(D)(3)(ii), (an "**Ownership Certificate**") stating that on the date of the Ownership Certificate that bearer note:

- (1) is owned by a person that is not a United States person;
- (2) is owned by a United States person that is described in United States Treasury Regulations Section 1.163-5(c)(2)(i)(D)(6); or
- (3) is owned by a United States or foreign financial institution for the purposes of resale during the Restricted Period,

and, in addition, if the owner of the bearer note is a United States or foreign financial institution described in clause (3) above, whether or not also described in clause (1) or clause (2) above, the financial institution certifies that it has not acquired the bearer note for purposes of resale directly or indirectly to a United States person or to a person within the United States or its possessions.

The relevant Issuer will make payments on bearer notes only outside the United States and its possessions except as permitted by the above regulations.

As used herein, "**United States person**" means, for United States federal income tax purposes, (i) a citizen or resident of the United States; (ii) a corporation, partnership or other entity created or organized in or under the laws of the United States or any political subdivision thereof; (iii) an estate or trust the income of which is subject to United States federal income taxation regardless of its source; or (iv) any trust if a court within the United States is able to exercise primary supervision over the administration of the trust, and one or more United States persons have the authority to control all substantial decisions of the trust.

## SUMMARY OF PROVISIONS RELATING TO THE ENGLISH LAW NOTES WHILE IN GLOBAL FORM

### Clearing System Accountholders

Each Global Note will be in bearer form. Consequently, in relation to any Notes (or any Tranche thereof) represented by a Global Note, references in "Terms and Conditions of the English Law Notes" to "Noteholder" are references to the bearer of the relevant Global Note which, for so long as the Global Note is held by a Bearer Note Depositary, will be that Bearer Note Depositary.

Each of the persons shown in the records of Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system as being entitled to an interest in a Global Note (each an "**Accountholder**") must look solely to Euroclear and/or Clearstream, Luxembourg and/or such other relevant clearing system (as the case may be) for such Accountholder's share of each payment made by the relevant Issuer to the bearer of such Global Note and in relation to all other rights arising under the Global Note, including any right to exchange any exchangeable Notes or any right to require the relevant Issuer to repurchase such Notes. The respective rules and procedures of Euroclear and Clearstream, Luxembourg and any other relevant clearing system from time to time will determine the extent to which, and the manner in which, Accountholders may exercise any rights arising under the Global Note and the timing requirements for meeting any deadlines for the exercise of those rights. For so long as the relevant Notes are represented by the Global Note, Accountholders shall have no claim directly against the relevant Issuer in respect of payments due under the Notes and such obligations of the relevant Issuer will be discharged by payment to the bearer of the Global Note.

### Exchange of Temporary Global Notes

If:

- (a) a Permanent Global Note has not been delivered or the principal amount thereof increased by 5:00 p.m. (London time) on the seventh day after the bearer of a Temporary Global Note has requested exchange of an interest in the Temporary Global Note for an interest in a Permanent Global Note; or
- (b) a Temporary Global Note (or any part thereof) has become due and payable in accordance with the terms and conditions of such Temporary Global Note as set out in "Terms and Conditions of the English Law Notes" or the date for final redemption of a Temporary Global Note has occurred and, in either case, payment in full of the amount of principal falling due with all accrued interest thereon has not been made to the bearer of the Temporary Global Note in accordance with the terms of the Temporary Global Note on the due date for payment,

then the Temporary Global Note (including the obligation to deliver a Permanent Global Note or increase the principal amount thereof, as the case may be) will become void at 5:00 p.m. (London time) on such seventh day (in the case of (a) above) or at 5:00 p.m. (London time) on such due date (in the case of (b) above) and the bearer of the Temporary Global Note will have no further rights thereunder (but without prejudice to the rights which the bearer of the Temporary Global Note or others may have in respect of English Law Notes under (i) in respect of English Law Notes issued by Morgan Stanley, the Morgan Stanley Deed of Covenant; (ii) in respect of English Law Notes issued by Morgan Stanley Jersey, the MSJ Deed of Covenant; (iii) in respect of English Law Notes issued by an Additional Issuer, a deed of covenant to be executed by such Additional Issuer on or prior to the date on which such Additional Issuer accedes to the Program (an "**Additional Deed of Covenant**")). Under the Morgan Stanley Deed of Covenant, the MSJ Deed of Covenant or, as the case may be, any Additional Deed of Covenant, persons shown in the records of Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system as being entitled to an interest in a Temporary Global Note in respect of English Law Notes will acquire directly against the relevant Issuer all those rights to which they would have been entitled if, immediately before such Temporary Global Note became void, they had been the holders of Definitive Notes in an aggregate principal amount equal to the principal amount of English Law Notes they were shown as holding in the records of Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system.

## **Exchange of Permanent Global Notes**

Whenever a Permanent Global Note is to be exchanged for Definitive Notes, the relevant Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Notes, duly authenticated and with Coupons and Talons attached (if so specified in the applicable Final Terms), in an aggregate principal amount equal to the principal amount of the Permanent Global Note to the bearer of the Permanent Global Note against the surrender of the Permanent Global Note at the Specified Office of the Fiscal Agent within 30 days of the bearer requesting such exchange.

If:

- (a) in the case of Notes issued by Morgan Stanley, Definitive Notes have not been delivered by 5:00 p.m. (London time) on the thirtieth day after the bearer of a Permanent Global Note has duly requested exchange of the Permanent Global Note for Definitive Notes; or
- (b) a Permanent Global Note was originally issued in exchange for part only of a Temporary Global Note representing the Notes and such Temporary Global Note becomes void in accordance with its terms; or
- (c) a Permanent Global Note (or any part of it) has become due and payable in accordance with the terms and conditions of such Permanent Global Note as set out in "Terms and Conditions of the English Law Notes" or the date for final redemption of the Notes has occurred and, in either case, payment in full of the amount of principal falling due with all accrued interest thereon has not been made to the bearer of the Permanent Global Note in accordance with the terms of the Permanent Global Note on the due date for payment,

then the Permanent Global Note (including the obligation to deliver Definitive Notes) will become void at 5:00 p.m. (London time) on such thirtieth day (in the case of (a) above) or at 5:00 p.m. (London time) on the date on which such Temporary Global Note becomes void (in the case of (b) above) or at 5:00 p.m. (London time) on such due date (in the case of (c) above) and the bearer of the Permanent Global Note will have no further rights thereunder (but without prejudice to the rights which the bearer of the Permanent Global Note or others may have in respect of English Law Notes under the Morgan Stanley Deed of Covenant, the MSJ Deed of Covenant, the MSBV Deed of Covenant or, as the case may be, any Additional Deed of Covenant). Under the Morgan Stanley Deed of Covenant, the MSJ Deed of Covenant, the MSBV Deed of Covenant or, as the case may be, any Additional Deed of Covenant, persons shown in the records of Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system in force as being entitled to an interest in a Permanent Global Note in respect of English Law Notes will acquire directly against the relevant Issuer all those rights to which they would have been entitled if, immediately before such Permanent Global Note became void, they had been the holders of Definitive Notes in an aggregate principal amount equal to the principal amount of English Law Notes they were shown as holding in the records of Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system.

## **Specified Denomination of Notes issued by MSBV**

Each Note issued by MSBV (the "**MSBV Notes**") will be issued with the Specified Denomination of at least EUR 1,000 per MSBV Note (or its equivalent in the currency in which such MSBV Note is denominated). For so long as the MSBV Notes are represented by a Global Note and Euroclear and Clearstream, Luxembourg so permit, the MSBV Notes shall be tradeable in minimum nominal amounts of at least EUR 1,000 per MSBV Note (or its equivalent) and integral multiples of any amount thereafter, as specified in the applicable Final Terms. If Definitive Notes are required to be issued in the limited circumstances specified in the Permanent Global Note they will only be printed and issued in denominations of at least EUR 1,000 per MSBV Note (or its equivalent). Accordingly, if Definitive Notes are required to be issued, a Noteholder holding MSBV Notes having an original nominal amount which cannot be fully represented by Definitive Notes in the denomination of at least at least EUR 1,000 per MSBV Note (or its equivalent) will not be able to receive a Definitive Note in respect of the original nominal amount of the MSBV Notes by which the original nominal amount of such holding of MSBV Notes exceeds the next lowest integral multiple of at least EUR 1,000 per MSBV Note (or its equivalent),



the "**Excess Amount**") and will not be able to receive interest or principal in respect of such Excess Amount. Furthermore, at any meetings of Noteholders while MSBV Notes are represented by a Global Note any vote cast shall only be valid if it is in respect of at least EUR 1,000 (or its equivalent) in nominal amount and no vote may be cast in respect of any smaller nominal amount.

### **Conditions Applicable to Global Notes**

Each Global Note will contain provisions which modify the terms and conditions set out in "Terms and Conditions of the English Law Notes" as they apply to the Global Note. The following is a summary of certain of those provisions:

*Payments:* All payments in respect of the Global Note (except in the case of Global Notes in NGN form) will be made against presentation and (in the case of payment of principal in full with all interest accrued thereon) surrender of the Global Note at the Specified Office of any paying agent and will be effective to satisfy and discharge the corresponding liabilities of the relevant Issuer in respect of the Notes. On each occasion on which a payment of principal or interest is made in respect of the Global Note, the relevant Issuer shall procure that the same is noted in a schedule thereto.

*Exercise of put option:* In order to exercise the Noteholder's put option set out in Condition 13.9 (*Redemption at the option of Noteholders*) of "Terms and Conditions of the English Law Notes", the bearer of the Permanent Global Note must, within the period specified therein for the deposit of the relevant Note and put notice, give written notice of such exercise to the Fiscal Agent and/or such other person as is specified in the relevant Final Terms specifying the principal amount of Notes in respect of which such option is being exercised. Any such notice will be irrevocable and may not be withdrawn.

*Partial exercise of call option:* In connection with an exercise of the option contained in Condition 13.7 (*Redemption at the option of the Issuer*) of "Terms and Conditions of the English Law Notes" in relation to some but not all of the Notes, the Permanent Global Note may be redeemed in part in the principal amount specified by the relevant Issuer in accordance with the provisions set out therein and the Notes to be redeemed will not be selected as provided therein.

*Notices:* Notwithstanding Condition 24 (*Notices*) of "Terms and Conditions of the English Law Notes", while all the Notes are represented by a Permanent Global Note (or by a Permanent Global Note and/or a Temporary Global Note) and the Permanent Global Note is (or the Permanent Global Note and the Temporary Global Note are) deposited with a Bearer Note Depositary, notices to Noteholders may be given by delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system and, in any case, such notices shall be deemed to have been given to the Noteholders in accordance with Condition 24 (*Notices*) of "Terms and Conditions of the English Law Notes", on the date of delivery to Euroclear and/or Clearstream, Luxembourg and/or any other relevant clearing system.

*Redenomination:* If the Notes are redenominated pursuant to Condition 27 (*Redenomination, Renominalisation and Reconventioning*) of "Terms and Conditions of the English Law Notes" then following redenomination:

- (a) if Definitive Notes are required to be issued, they shall be issued at the expense of the relevant Issuer in the denominations of euro 0.01, euro 1,000, euro 10,000, euro 100,000 and such other denominations as the relevant Fiscal Agent shall determine and notify to the Noteholders; and
- (b) the amount of interest due in respect of Notes represented by a Permanent Global Note and/or a Temporary Global Note will be calculated by reference to the aggregate principal amount of such Notes and the amount of such payment shall be rounded down to the nearest euro 0.01.

## ERISA

The Notes may not be acquired or held by, or acquired with the assets of, any employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), or any individual retirement account or plan subject to Section 4975 of the Code.

## UNITED STATES FEDERAL TAXATION

**This discussion is limited to the Federal tax issues addressed below. Additional issues may exist that are not addressed in this discussion and that could affect the Federal tax treatment of the transaction. Because this tax disclosure was written in connection with the marketing of the Program for the Issuance of Notes, Series A and B, it cannot be used by any holder for the purpose of avoiding penalties that may be asserted against the holder. Holders should seek their advice based upon their particular circumstances from an independent tax advisor.**

*References to "Notes" herein refer only to Notes issued by Morgan Stanley, Morgan Stanley Jersey or MSBV, not to Notes issued by an Additional Issuer.*

In the opinion of Davis Polk and Wardwell, counsel to us, the following are the material U.S. federal tax consequences of ownership and disposition of the Notes by Non-U.S. Holders (as defined below). This summary is based on the Internal Revenue Code of 1986 (the "Code"), administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations, all as of the date hereof, changes to any of which subsequent to the date of this Base Prospectus may affect the tax consequences described herein.

This summary does not discuss all of the tax consequences that may be relevant to holders in light of their particular circumstances or to holders subject to special rules, such as:

- persons other than Non-U.S. Holders;
- nonresident alien individuals who have lost their United States citizenship or who have ceased to be treated as resident aliens; or
- corporations that are treated as foreign or domestic personal holding companies, controlled foreign corporations, or passive foreign investment companies.

Persons considering the purchase of Notes should consult their own tax advisors with regard to the application of the United States federal income tax laws to their particular situations, as well as any tax consequences arising under the laws of any state, local or foreign taxing jurisdiction.

As used herein, the term "Non-U.S. Holder" means a beneficial owner of a Note that is for United States federal income tax purposes:

- a nonresident alien individual;
- a foreign corporation;
- a nonresident alien fiduciary of a foreign estate or trust; or
- a foreign partnership one or more of the members of which is a nonresident alien individual, a foreign corporation or a nonresident alien fiduciary of a foreign trust or estate; or
- "Non-U.S. Holder" does not include a holder who is an individual present in the United States for 183 days or more in the taxable year of disposition and who is not otherwise a resident of the United States for U.S. federal income tax purposes. Such a holder is urged to consult his or her own tax advisors regarding the U.S. federal income tax consequences of the sale, exchange or other disposition of a Note.

## Notes

Except as otherwise discussed below or indicated in the applicable Final Terms, a Non-U.S. Holder will generally not be subject to United States federal income tax, including withholding tax, on payments of principal, or interest (including original issue discount, if any) on a Note, or on proceeds from the sale or other disposition of a Note, provided that for purposes of United States federal income tax law:

- the Note is treated as indebtedness for United States federal income purposes; Notes may be issued at a premium, which could make them non-debt for tax purposes;
- the payments or proceeds are not effectively connected with the conduct of a trade or business within the United States by the holder;
- the holder does not own (directly or by attribution) ten percent or more of the total combined voting power of all classes of stock of Morgan Stanley entitled to vote;
- the holder is not a bank holding the Note in the context of an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business; and
- the holder does not have a "tax home" (as defined in section 911(d)(3) of the Code) or an office or other fixed place of business in the United States.

## Exchangeable Notes

Except as otherwise indicated in the applicable Final Terms, a Non-U.S. Holder will generally not be subject to United States federal income tax, including withholding tax, with regard to an Exchangeable Note if:

- the Note is treated as indebtedness for United States federal income tax purposes;
- the Note is exchangeable only into securities that are actively traded, into a basket of securities that are actively traded or an index or indices of securities that are actively traded; and
- the other requirements for exemption from tax listed above under "Notes" are met.

With regard to the above requirements, Optionally Exchangeable Notes for which the principal amount payable in cash equals or exceeds the issue price (i.e. the first price at which a substantial amount of the Optionally Exchangeable Notes is sold to the public) will generally be treated as indebtedness for United States federal income tax purposes. No opinion is expressed herein as to the impact of the "United States real property holding corporation" rules, which could affect the taxation of Non-U.S. Holders of Exchangeable Notes in certain circumstances. Non-U.S. Holders intending to purchase Exchangeable Notes should refer to the discussion relating to taxation in the applicable Final Terms for disclosure, if any is deemed necessary, concerning the applicability of those rules. For information regarding the United States federal income tax consequences of the ownership and disposition of the property received in exchange for the Note, please refer to the documents described in the applicable Final Terms.

## Notes Linked to Commodity Prices, Single Securities, Baskets of Securities or Indices and Credit-Linked Notes

Except to the extent discussed above under "Exchangeable Notes," the United States federal income tax consequences to a Non-U.S. Holder of the ownership and disposition of Notes that have principal or interest determined by reference to commodity prices, securities of entities not affiliated with the relevant Issuer, baskets of securities or indices or the credit of entities not affiliated with the relevant Issuer may vary depending upon the exact terms of the Notes and related factors. Notes containing any of those features may be subject to rules that differ from the general rules discussed above. In these instances, the applicable Final Terms will disclose such special rules. Non-U.S. Holders intending to purchase such Notes should refer to the discussion relating to taxation in the applicable Final Terms, if deemed necessary, for disclosure concerning the applicability of the rules.

## **Backup Withholding and Information Reporting**

With respect to Notes that are treated as indebtedness for U.S. federal income tax purposes, a Non-U.S. Holder of a Note will generally not be subject to backup withholding or information reporting with respect to payments on, or proceeds from the sale or redemption of, the Note.

Non-U.S. Holders of Notes should consult their own tax advisors regarding the application of information reporting and backup withholding in their particular situations, the availability of an exemption therefrom and the procedure for obtaining the exemption, if available. Any amounts withheld from a payment to a Non-U.S. Holder under the backup withholding rules will be allowed as a credit against the holder's United States federal income tax liability and may entitle the holder to a refund, provided that the required information is furnished to the United States Internal Revenue Service.

## **Estate Tax**

Subject to benefits provided by an applicable estate tax treaty, a Note that is treated as indebtedness for U.S. federal income tax purposes will generally be excluded from the gross estate of a Non-U.S. Holder for U.S. federal estate tax purposes upon the individual's death unless, at such time, interest payments on the Note would have been:

- subject to U.S. federal withholding tax without regard to any certification that such holder is not a "United States person" within the meaning of Section 7701(a)(30) of the Code, not taking into account an elimination of such U.S. federal withholding tax due to the application of an income tax treaty; or
- effectively connected to the conduct by the holder of a trade or business in the United States.

Non-U.S. Holders should consult their own tax advisors regarding the U.S. federal estate tax consequences of an investment in the Notes and the availability of benefits provided by an applicable estate tax treaty, if any.

## UNITED KINGDOM TAXATION

*The following disclosure applies only in respect of Notes issued by Morgan Stanley, Morgan Stanley Jersey or MSBV and not in respect of Notes issued by an Additional Issuer or any substitute issuer. References in this section on United Kingdom taxation to "Notes" refer only to Notes issued by Morgan Stanley, Morgan Stanley Jersey or MSBV, and references to Noteholders should be construed accordingly. The following assumes that Morgan Stanley, Morgan Stanley Jersey and MSBV are not resident in the United Kingdom for United Kingdom tax purposes and are not issuing the Notes for the purposes of a trade or other business carried on by them in the United Kingdom and that the interest on the Notes does not have a United Kingdom source.*

*The following disclosure applies only when any interest on Notes issued by Morgan Stanley, Morgan Stanley Jersey or MSBV is paid and the payment of such interest is entrusted to any person in the United Kingdom for payment, distribution or collection.*

The following is a summary of the obligations in certain circumstances to provide information to Her Majesty's Revenue and Customs at the date hereof in relation to payments of principal and interest in respect of the Notes. The comments do not deal with other United Kingdom tax aspects of acquiring, holding or disposing of the Notes. The comments relate only to the position of persons who are absolute beneficial owners of the Notes. Prospective Noteholders should be aware that the particular terms of issue of any series of Notes as specified in the applicable Final Terms may affect the tax treatment of that and other series of Notes. The following is a general guide and should be treated with appropriate caution. Noteholders who are in any doubt as to their tax position should consult their professional advisers.

Noteholders should note that where any interest on Notes is paid to them (or to any person acting on their behalf) by any person in the United Kingdom acting on behalf of Morgan Stanley (in the case of Notes issued by Morgan Stanley) or Morgan Stanley Jersey (in the case of Notes issued by Morgan Stanley Jersey) or MSBV (in the case of Notes issued by MSBV) (a "paying agent"), or is received by any person in the United Kingdom acting on behalf of the relevant Noteholder (other than solely by clearing or arranging the clearing of a cheque) (a "collecting agent"), then the paying agent or the collecting agent (as the case may be) may, in certain cases, be required to supply to Her Majesty's Revenue and Customs details of the payment and certain details relating to the Noteholder (including the Noteholder's name and address). These provisions will apply whether or not the interest has been paid subject to withholding or deduction for or on account of United Kingdom income tax and whether or not the Noteholder is resident in the United Kingdom for United Kingdom taxation purposes. Where the Noteholder is not so resident, the details provided to Her Majesty's Revenue and Customs may, in certain cases, be passed by Her Majesty's Revenue and Customs to the tax authorities of the jurisdiction in which the Noteholder is resident for taxation purposes.

For the purposes of the paragraph above, references to "interest" should be taken, for practical purposes, as including payments made by Morgan Stanley as guarantor in respect of interest on the Notes.

The provisions referred to above may also apply, in certain circumstances, to payments made on redemption of any Notes where the amount payable on redemption is greater than the issue price of the Notes.

The references to "interest" in this section on United Kingdom taxation mean "interest" as understood in United Kingdom tax law. The statements in this section on United Kingdom taxation do not take any account of any different definitions of "interest" or "principal" which may prevail under any other law or which may be created by the terms and conditions of the Notes or any related documentation.

## **JERSEY TAXATION**

Prospective purchasers of Notes issued by Morgan Stanley Jersey should consult their tax advisors as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of Jersey/United States of America of acquiring, holding and disposing of such securities and receiving payments of interest, principal and/or other amounts under such securities.

The following summary is based on the laws and practices currently in force in Jersey at the date of this document and is subject to changes therein.

Holders of Notes issued by Morgan Stanley Jersey (other than residents of Jersey) are not subject to any tax in Jersey in respect of the holding, sale or other disposition of such securities. So long as Morgan Stanley Jersey maintains its “exempt company” status, interest on such securities may be paid by Morgan Stanley Jersey without withholding or deduction for or on account of Jersey income tax.

No stamp duties are payable in Jersey on the acquisition, ownership, redemption, sale or other disposal of such securities. Stamp duty is payable in Jersey on the registration of Probate or Letters of Administration relating to the death of an individual holder of such securities with assets situate in Jersey, which is calculated by reference to the value of the holder’s estate in Jersey.

As part of an agreement reached in connection with the European Union (the “EU”) directive on the taxation of savings income in the form of interest payments, and in line with steps taken by other relevant third countries, Jersey introduced with effect from 1 July 2005 a retention tax system in respect of payments of interest, or other similar income, made to an individual beneficial owner resident in an EU Member State by a paying agent established in Jersey. The retention tax system applies for a transitional period prior to the implementation of a system of automatic communication to EU Member States of information regarding such payments. During this transitional period, such an individual beneficial owner resident in an EU Member State will be entitled to request a paying agent not to retain tax from such payments but instead to apply a system by which the details of such payments are communicated to the tax authorities of the EU Member State in which the beneficial owner is resident.

The retention tax system in Jersey is implemented by means of bilateral agreements with each of the EU Member States, the Taxation (Agreements with European Union Member States) (Jersey) Regulations 2005 and Guidance Notes issued by the Policy & Resources Committee of the States of Jersey. Based on these provisions and what is understood to be the current practice of the Jersey tax authorities, Morgan Stanley Jersey would not be obliged to levy retention tax in Jersey under these provisions in respect of interest payments made by it to a paying agent established outside Jersey.

### **European Union Code of Conduct on Business Taxation**

On 3 June 2003, the European Union Council of Economic and Finance Ministers reached political agreement on the adoption of a Code of Conduct on Business Taxation. Jersey is not a member of the EU, however, the Policy & Resources Committee of the States of Jersey has announced that, in keeping with Jersey’s policy of constructive international engagement, it intends to propose legislation to replace the Jersey exempt company regime by the end of 2008 with a general zero rate of corporate tax.

It is intended that the new corporate tax will preserve tax neutrality (and so retain the existing benefits of the exempt company regime through a revised fiscal structure). Unlike the exempt company regime, it is anticipated that the new regime will not require an annual application/election or the payment of any sum by the relevant company.

## NETHERLANDS TAXATION

*The following disclosure applies only in respect of Notes issued by MSBV and not in respect of Notes issued by Morgan Stanley, Morgan Stanley Jersey or an Additional Issuer or any substitute issuer. References in this section on Netherlands taxation to "Notes" refer only to Notes issued by MSBV and references to holders of Notes should be construed accordingly.*

The following summary outlines certain Netherlands tax consequences to holders of Notes. It is based on the current law and practice of the Netherlands, which is subject to changes that could prospectively or retrospectively affect the stated tax consequences. Prospective holders of Notes who may be in any doubt as to their respective tax positions should consult their own professional advisors.

### **Withholding Tax**

All payments under Notes may be made free of withholding or deduction of, for or on account of any taxes of whatever nature imposed, levied, withheld or assessed by the Netherlands or any political subdivision or taxing authority thereof or therein, provided that, with respect to Notes, (i) they have a fixed maturity of not more than 10 years or (ii) if they have no fixed maturity or a fixed maturity of more than 10 years, the interest on such Notes is not legally or *de facto* in whole or in part contingent on the profits of, or the distributions of profits by, MSBV, Morgan Stanley or any related entity or (iii) if they are subordinated and have no fixed maturity or a fixed maturity of more than 50 years, the payment of the interest is not contingent on the profit of, or distribution of profit by, MSBV, Morgan Stanley or any related entity.

### **Taxes on Income and Capital Gains**

A holder of Notes will not be subject to any Netherlands taxes on income or capital gains in respect of Notes, including such tax on any payment under Notes or in respect of any gain realised on the disposal, deemed disposal or exchange of Notes, provided that:

- (a) such holder is neither a resident nor deemed to be a resident of the Netherlands, nor, if he is an individual, has elected to be taxed as a resident of the Netherlands;
- (b) such holder does not have an enterprise or an interest in an enterprise that is, in whole or in part, carried on through a permanent establishment or a permanent representative in the Netherlands and to which enterprise or part of an enterprise, as the case may be, Notes are attributable;
- (c) if such holder is an individual, neither such holder nor any of his spouse, his partner, a person deemed to be his partner, or other persons sharing such person's house or household, or certain other of such persons' relatives (including foster children), (a) has indirectly the disposition of the proceeds of Notes, nor (b) has a substantial interest in MSBV, Morgan Stanley and/or any other entity that legally or *de facto*, directly or indirectly, has the disposition of the proceeds of Notes. For purposes of this clause (iii), a substantial interest is generally not present if a holder does not hold, alone or together with his spouse or partner, whether directly or indirectly, the ownership of, or certain other rights (including rights to acquire shares, whether or not already issued) over, (a) shares representing five percent or more of the total issued and outstanding capital (or of the issued and outstanding capital of any class of shares) of a company, (b) profit sharing certificates, or membership rights in a co-operative association, entitling the holder to five percent or more of the profits or of the liquidation distributions of a company or co-operative association, or (c) membership rights representing five percent or more of the voting rights in a co-operative association's general meeting;
- (d) if such holder is a company, such holder does not have a substantial interest in MSBV or if such holder does have such a substantial interest, it can be allocated to the holder's business assets. For purpose of this clause (iv), a substantial interest is generally not present if a holder does not hold, whether directly or indirectly, the ownership of, or certain other rights (including the rights to acquire shares, whether or not already issued) over shares representing five percent or more of the total issued and outstanding capital (or of the issued and outstanding capital of any class of

shares) of the Issuer, or (b) profit sharing certificates, entitling the holder to five per cent. or more of the profits or of the liquidation distributions of the Issuer; and

- (e) if such holder is an individual, such income or capital gain do not form "benefits from miscellaneous activities in the Netherlands" ("resultaat uit overige werkzaamheden in Nederland"), which would for instance be the case if the activities in the Netherlands with respect to Notes exceed "normal active asset management" ("normaal, actief vermogensbeheer").

A holder of Notes will not be subject to taxation in the Netherlands by reason only of the execution, delivery and/or enforcement of the documents relating to an issue of Notes or the performance by MSBV of its obligations thereunder or under Notes.

#### **Gift, Estate and Inheritance Taxes**

No gift, estate or inheritance taxes will arise in the Netherlands with respect to an acquisition of Notes by way of a gift by, or on the death of, a holder of Notes who is neither resident nor deemed to be resident in the Netherlands, unless:

- (a) such holder at the time of the gift has or at the time of his death had an enterprise or an interest in an enterprise that is or was, in whole or in part, carried on through a permanent establishment or a permanent representative in the Netherlands and to which enterprise or part of an enterprise, as the case may be, Notes are or were attributable; or
- (b) in the case of a gift of Notes by an individual who at the date of the gift was neither resident nor deemed to be resident in the Netherlands, such individual dies within 180 days after the date of the gift, while being resident or deemed to be resident in the Netherlands.

#### **Turnover Tax**

No Netherlands turnover tax will arise in respect of any payment in consideration for the issue of Notes, with respect to any payment by MSBV of principal, interest or premium (if any) on the Notes.

#### **Other Taxes and Duties**

No Netherlands capital tax, registration tax, custom duty, transfer tax, stamp duty or any other similar documentary tax or duty, other than court fees, will be payable in the Netherlands in respect of or in connection with the execution, delivery and/or enforcement by legal proceedings (including the enforcement of any foreign judgment in the Courts of the Netherlands) of the documents relating to the issue of Notes or the performance by MSBV of its obligations thereunder or under Notes.



## EUROPEAN UNION SAVINGS DIRECTIVE

On 3 June 2003, the EU Council of Economic and Finance Ministers adopted a new directive regarding the taxation of savings income (the "**EU Savings Tax Directive**") which applies from 1 July 2005. Under the EU Savings Tax Directive, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident in that other Member State; however, Austria, Belgium and Luxembourg will, unless they elect otherwise, instead apply a withholding system for a transitional period in relation to such payments, deducting tax at rates rising over time to 35%. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

A number of non-EU countries, and certain dependent or associated territories of certain Member States, have agreed to adopt similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction, to, or collected by such a person for, an individual resident in a Member State. In addition, the Member States have entered into reciprocal provisions of information or transitional withholding arrangements with certain of these dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such person for, an individual resident in one of these territories.

## SUBSCRIPTION AND SALE

Each Issuer is offering the Notes on a continuing basis through Morgan Stanley & Co. International Limited of 25 Cabot Square, Canary Wharf, London E14 4QA and Morgan Stanley & Co. Incorporated whose principal executive offices are at 1585 Broadway, New York, New York 10036, U.S.A., (the "**Distribution Agents**"), who have agreed to use reasonable efforts to solicit offers to purchase the Notes. Each Issuer will have the sole right to accept offers to purchase Notes and may reject any offer in whole or in part. The Distribution Agents will have the right to reject any offer to purchase Notes solicited by it in whole or in part. Each Issuer may pay the Distribution Agents, in connection with sales of the Notes resulting from a solicitation the Distribution Agents made or an offer to purchase received by the Distribution Agents, a commission, which may be in the form of a discount from the purchase price if the Distribution Agents are purchasing the Notes for their own account. Payment of the purchase price of the Notes will be required to be made in immediately available funds.

Each Issuer may also sell Notes to a Distribution Agent as principal for its own account at a price to be agreed upon at the time of sale. The Distribution Agents may resell any Notes they purchase as principal at prevailing market prices, or at other prices, as the Distribution Agents determine.

The arrangements for the offer and sale of the Notes from time to time are set out in the Regulation S Euro Distribution Agreement dated 11 July 2006 (as modified and restated from time to time, the "**Distribution Agreement**") among Morgan Stanley, Morgan Stanley Jersey, MSBV and the Distribution Agents (and any Additional Issuer that accedes to the Program). Pursuant to the Distribution Agreement, Morgan Stanley, Morgan Stanley Jersey, MSBV and the Distribution Agents have agreed (and any Additional Issuer that accedes to the Program shall agree) to indemnify each other against certain liabilities, or to contribute payments made in respect thereof. Morgan Stanley, Morgan Stanley Jersey and MSBV have also agreed (and any Additional Issuer that accedes to the Program shall agree) to reimburse the Distribution Agents for certain expenses. The Distribution Agreement makes provision for the appointment of additional Distribution Agents who may agree to become bound by its terms (either in relation to the Program generally or in relation to a particular Series of Notes) in an accession letter provided by such additional Distribution Agent to the Issuers.

In order to facilitate the offering of the Notes, the Distribution Agents may engage in transactions that stabilize, maintain or otherwise affect the price of the Notes or any other securities the prices of which may be used to determine payments on those Notes. Specifically, the Distribution Agents may overallocate in connection with any offering of the Notes, creating a short position in the Notes for their own accounts. In addition, to cover overallocations or to stabilize the price of the Notes or of any other securities, the Distribution Agents may bid for, and purchase, Notes or any other securities in the open market. Finally, in any offering of the Notes through a syndicate of underwriters, the underwriting syndicate may reclaim selling concessions allowed to an underwriter or a dealer for distributing the Notes in the offering if the syndicate repurchases previously distributed Notes in transactions to cover syndicate short positions, in stabilization transactions or otherwise. Any of these activities may stabilize or maintain the market price of the Notes above independent market levels. The Distribution Agents are not required to engage in these activities and may end any of these activities at any time.

### United States of America

The Notes have not been and will not be registered under the Securities Act and may not be offered, sold or delivered, *at any time*, within the United States or to, or for the account or benefit of, U.S. Persons. Each Distribution Agent (1) has acknowledged that the Notes have not been and will not be registered under the Securities Act, or any securities laws of any state in the United States, are subject to U.S. tax law requirements, and the Notes are not being offered or sold and may not be offered, sold or delivered at any time, directly or indirectly, within the United States or to or for the account or benefit of U.S. Persons (as defined either in Regulation S under the Securities Act or the Code); (2) has represented, as a condition to acquiring any interest in the Notes, that neither it nor any persons for whose account or benefit the Notes are being acquired is a U.S. Person, is located in the United States, or was solicited to purchase Notes while present in the United States; (3) has agreed not to offer, sell or deliver any of the Notes, directly or indirectly, in the United States to any U.S. Person; (4) has agreed that, at or prior to

confirmation of sale of any Notes (whether upon original issuance or in any secondary transaction), it will have sent to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases Notes from it a written notice containing language substantially the same as the foregoing. As used herein, "**United States**" means the United States of America (including the states and the District of Columbia), its territories and possessions.

In addition, the Distribution Agents have represented and agreed that they have not offered or sold Notes and will not offer or sell Notes *at any time* except in accordance with Rule 903 of Regulation S under the Securities Act. Accordingly, the Distribution Agents have represented and agreed that neither they, their affiliates (if any) nor any person acting on its or their behalf has engaged or will engage in any directed selling efforts with respect to Notes, and it and they have complied and will comply with the offering restrictions requirements of Regulation S. Terms used in this paragraph have the meanings given to them by Regulation S.

In compliance with United States federal income tax laws and regulations, bearer notes, including bearer notes in global form, are subject to U.S. tax law requirements and may not be offered, sold or delivered, directly or indirectly, within the United States or its possessions or to U.S. Persons. The Notes will be issued in accordance with the provisions of United States Treasury Regulation § 1.163-5(c)(2)(i)(D). Terms used in this paragraph have the meanings given to them by the Code.

### **European Economic Area**

Each Distribution Agent has represented, warranted and agreed that it has not offered and will not offer any Notes to persons in any Member State of the European Economic Area, except that it may offer Notes in any Member State:

- (a) in the period beginning on the date of publication of a prospectus in relation to those Notes which has been approved by the competent authority in a Member State in accordance with the Prospectus Directive and, where appropriate, notified to the competent authority in the Member State in which such offer is being made in accordance with Article 18 of the Prospectus Directive and ending on the date which is 12 months after the date of such publication;
- (b) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;
- (c) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual turnover of more than €50,000,000, all as shown in its last annual or consolidated accounts; or
- (d) at any time in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression "offer" in relation to any Notes in any Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression "Prospectus Directive" means Directive 2003/71/EC and includes any relevant implementing measure in each relevant Member State.

### **United Kingdom**

In relation to each Tranche of Notes, each Distribution Agent subscribing for or purchasing such Notes has represented to, warranted and agreed with, or will represent to, warrant and agree with, the relevant Issuer and, if the Notes are issued by Morgan Stanley Jersey or MSBV, the Guarantor that:

- (a) *Notes with maturities of less than one year*: in relation to any Notes which have a maturity of less than one year, (a) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and

(b) it has not offered or sold and will not offer or sell any Notes other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Notes would otherwise constitute a contravention of section 19 of the Financial Services and Markets Act 2000 (the “FSMA”) by the Issuer;

- (b) Financial promotion: it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA would not, if it was not an authorised person, apply to the relevant Issuer; and
- (c) General compliance: it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Notes in, from or otherwise involving the United Kingdom.

### **Ireland**

Each Distribution Agent has represented and agreed that:

- (a) to the extent applicable, it will not underwrite the issue of or place the Notes otherwise than in conformity with the provisions of the Irish Investment Intermediaries Act, 1995 (as amended), including, without limitation, Sections 9 and 50 and will conduct itself in accordance with any code of conduct drawn up pursuant to Section 37; and
- (b) in relation to any Notes having a maturity of less than one year, it has ensured compliance with the requirements of the Notice of the Central Bank of Ireland of Exemptions granted under Section 8(2) of the Central Bank Act 1971, as amended and any other successor or related requirements with respect to the issue of Securities of such maturity.

### **Jersey**

Each Distribution Agent has severally represented to, and agreed with, Morgan Stanley Jersey that:

- (a) it has not offered or sold and will not offer or sell any Notes issued by Morgan Stanley Jersey under the Program in any jurisdiction in circumstances which have resulted or will result in an invitation to the public having been made within the meaning of the Companies (Jersey) Law 1991, as amended; and
- (b) it will not take any action on behalf of Morgan Stanley Jersey that would result in Morgan Stanley Jersey being required to become registered under the Financial Services (Jersey) Law 1998, as amended.

#### **NO OWNERSHIP BY U.S. PERSONS**

**The Notes may not be legally or beneficially owned by U.S. Persons at any time. Each holder and each beneficial owner of a Note hereby represents, as a condition to purchasing or owning the Note or any beneficial interest therein, that neither it nor any person for whose account or benefit the Notes are being purchased is located in the United States, is a U.S. Person or was solicited to purchase the Notes while present in the United States. Each holder and each beneficial owner of a Note hereby agrees not to offer, sell or deliver any of the Notes, at any time, directly or indirectly in the U.S. or to any U.S. Person. The term "U.S. Person" will have the meaning ascribed to it in both Regulation S under the Securities Act and the Code.**

## GENERAL INFORMATION

Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The appropriate code for each issue allocated by Euroclear and Clearstream, Luxembourg will be contained in the applicable Final Terms. Transactions will normally be effected for settlement not earlier than two business days after the date of the transaction.

For so long as this Base Prospectus remains in effect or any securities issued by Morgan Stanley, Morgan Stanley Jersey or MSBV remain outstanding, the following documents will be available from the date hereof in physical or electronic form, during usual business hours on any week day, for inspection at JPMorgan Chase Bank, Trinity Tower, 9 Thomas More Street, London E1W 1YT and also at the principal executive offices of Morgan Stanley and the registered offices of Morgan Stanley Jersey and MSBV:

- (a) copies of the Distribution Agreement, the Issue and Paying Agency Agreement dated 30 November 2000 (as modified and restated on 4 December 2001 and 30 June 2005, and as further modified and restated on 11 July 2006 and as from time to time further modified and/or restated), the accession agreement dated as of 10 June 2002 relating to Morgan Stanley Jersey, the accession agreement dated as of 16 April 2004 relating to MSBV, the Morgan Stanley Deed of Covenant, the MSJ Deed of Covenant, the MSBV Deed of Covenant, the guarantee dated 10 June 2002 provided by Morgan Stanley, all of Morgan Stanley Jersey's and MSBV's future published financial statements and all of Morgan Stanley's future Annual, Quarterly and Current Reports. Morgan Stanley's Quarterly Reports on Form 10 Q contain unaudited quarterly financial statements;
- (b) the Certificate of Incorporation and Memorandum and Articles of Association of Morgan Stanley Jersey (these shall not be available at the registered office of MSBV);
- (c) the Deed of Incorporation of MSBV (this shall not be available at the registered office of Morgan Stanley Jersey);
- (d) the Certificate of Incorporation and Amended and Restated By-laws of Morgan Stanley;
- (e) all reports, letters and other documents, historical financial information, valuations and statements by any expert any part of which is included or referred to herein;
- (f) the audited accounts of MSBV for the financial years ended 30 November 2004 and 30 November 2005 (these shall not be available at the registered office of Morgan Stanley Jersey);
- (g) the audited accounts of Morgan Stanley Jersey for the financial years ended 30 November 2005 and 30 November 2004 (these shall not be available at the registered office of MSBV);
- (h) Morgan Stanley's Annual Report on Form 10-K for the year ended 30 November 2005, including any amendments thereto, which contain the audited consolidated financial statements of Morgan Stanley for the years ended 30 November 2005 and 30 November 2004;
- (i) a copy of this Base Prospectus and any document incorporated by reference herein;
- (j) any supplement to this Base Prospectus; and
- (k) any Final Terms (relating to listing and outstanding issues of Notes, issued after the date of this Base Prospectus.

Any statement contained in this Base Prospectus or in a document incorporated or deemed to be incorporated by reference in this Base Prospectus will be deemed to be modified or superseded for purposes of this Base Prospectus, to the extent that a statement contained in this Base Prospectus or in any subsequently filed document that also is or is deemed to be incorporated by reference in this Base

Prospectus and in respect of which a supplement to this Base Prospectus has been prepared modifies or supersedes the statement. Any statement so modified or superseded will not be deemed, except as so modified or superseded, to constitute a part of this Base Prospectus.

### **Morgan Stanley**

The Program was authorised by Morgan Stanley pursuant to resolutions adopted at a meeting of the Board of Directors of Morgan Stanley held on 17 June 2003, as amended and updated pursuant to resolutions adopted at a meeting of the Board of Directors of Morgan Stanley held on 14 December 2004 and further amended by resolutions dated 20 September 2005.

### **Morgan Stanley Jersey**

There are no, nor have there been any legal, governmental or arbitration proceedings (including any such proceedings which are pending or threatened of which Morgan Stanley Jersey is aware), during the 12 month period before the date of this Base Prospectus, involving Morgan Stanley Jersey which may have or have had in the recent past, a significant effect on the financial position or profitability of Morgan Stanley Jersey.

Deloitte & Touche, Chartered Accountants and Registered Auditors of PO Box 403, Lord Coutanche House, 66-68 Esplanade, St Helier, Jersey JE4 8WA have audited the financial statements of Morgan Stanley Jersey for the years ended 30 November 2003, 2004 and 2005 and unqualified opinions have been reported thereon.

Morgan Stanley Jersey does not publish interim financial figures.

The role of Morgan Stanley Jersey as issuer under the Program was authorised by resolutions of the Board of Directors of Morgan Stanley Jersey passed on 7 June 2002 and 10 July 2006.

Morgan Stanley Jersey has obtained or will obtain all necessary consents, approvals and authorisations in connection with the issue and performance of Notes. In particular, the Jersey Financial Services Commission (the “**Commission**”) has given, and has not withdrawn, its consent under Article 4 of the Control of Borrowing (Jersey) Order 1958 to the issue of Notes under the Program by Morgan Stanley Jersey. The Commission is protected by the Control of Borrowing (Jersey) Law 1947 against liability arising from the discharge of its functions under that law.

A copy of this document has been delivered to the registrar of companies in accordance with Article 5 of the Companies (General Provisions) (Jersey) Order 2002, and the registrar has given, and has not withdrawn, consent to its circulation.

It must be distinctly understood that, in giving these consents, neither the registrar of companies nor the Commission takes any responsibility for the financial soundness of Morgan Stanley Jersey or for the correctness of any statements made, or opinions expressed, with regard to it.

If you are in any doubt about the contents of this document you should consult your stockbroker, bank manager, solicitor, accountant or other financial adviser.

It should be remembered that the price of securities and the income from them can go down as well as up.

### **Financial Services (Jersey) Law 1998**

Nothing in this Base Prospectus, any Final Terms or anything communicated to the holders of Notes issued by Morgan Stanley Jersey or potential holders of such securities by or on behalf of Morgan Stanley Jersey is intended to constitute or should be construed as advice on the merits of the purchase of or subscription for such securities or the exercise of any rights attached thereto for the purpose of the Financial Services (Jersey) Law 1998, as amended.

### **Collective Investment Funds (Restriction of Scope) (Jersey) Order 2000**

**The investments described in this document do not constitute a collective investment fund for the purpose of the Collective Investment Funds (Jersey) Law 1988, as amended, on the basis that they are investment products designed for financially sophisticated investors with specialist knowledge of, and experience of investing in, such investments, who are capable of fully evaluating the risks involved in making such investments and who have an asset base sufficiently substantial as to enable them to sustain any loss that they might suffer as a result of making such investments. These investments are not regarded by the Jersey Financial Services Commission as suitable investments for any other type of investor.**

**Any individual intending to invest in any investment described in this document should consult his or her professional adviser and ensure that he or she fully understands all the risks associated with making such an investment and has sufficient financial resources to sustain any loss that may arise from it.**

### **MSBV**

There are no, nor have there been any legal, governmental or arbitration proceedings (including any such proceedings which are pending or threatened of which MSBV is aware), during the 12 month period before the date of this Base Prospectus, involving MSBV which may have or have had in the recent past, a significant effect on the financial position or profitability of MSBV.

Deloitte Accountants B.V., independent auditors and certified public accountants of Orlyplein 50, 1043 DP Amsterdam, The Netherlands have audited the financial statements of MSBV for the years ended 30 November 2003, 30 November 2004 and 30 November 2005 and an unqualified opinion has been reported thereon.

MSBV does not publish interim financial statements.

The role of MSBV as issuer under the Program was authorised by resolutions of the Board of Directors of MSBV passed on 16 April 2004 and 10 July 2006.



**PRINCIPAL EXECUTIVE OFFICES OF  
MORGAN STANLEY**

1585 Broadway  
New York, New York 10036  
U.S.A.  
Tel: +1 (212) 761 4000

**REGISTERED OFFICE OF MORGAN  
STANLEY IN DELAWARE**

The Corporation Trust Center  
1209 Orange Street  
Wilmington, Delaware 19801  
U.S.A.

**REGISTERED OFFICE OF MORGAN STANLEY (JERSEY) LIMITED**

22 Grenville Street  
St. Helier  
Jersey  
JE4 8PX  
Channel Islands  
Tel: +44 (0) 1534 609000

**REGISTERED OFFICE OF MORGAN STANLEY B.V.**

Locatellikade 1  
1076 AZ Amsterdam  
The Netherlands  
Tel: +31 20 57 55 600

**TRUSTEE, PRINCIPAL PAYING AGENT AND FISCAL AGENT AND EXCHANGE  
AGENT FOR NOTES**

JPMorgan Chase Bank, N.A.  
Trinity Tower  
9 Thomas More Street  
London E1W 1YT  
U.K.

**ADDITIONAL PAYING AGENT**

J.P. Morgan Bank (Ireland) plc  
J.P. Morgan House  
International Finance Service Centre  
Dublin 1  
Ireland

## **LEGAL ADVISORS TO THE ISSUERS**

*As to English law:*  
Clifford Chance  
Limited Liability Partnership  
10 Upper Bank Street  
Canary Wharf  
London E14 5JJ  
U.K.

*As to U.S. law:*  
Davis Polk & Wardwell  
450 Lexington Avenue  
New York, New York 10017  
U.S.A.

*As to Jersey law:*  
Mourant du Feu & Jeune  
PO Box 87  
22 Grenville Street  
St Helier  
Jersey JE4 8PX  
Channel Islands

## **LEGAL ADVISORS TO THE DISTRIBUTION AGENTS**

*As to English law:*  
Lovells  
Atlantic House  
Holborn Viaduct  
London EC1A 2FG  
U.K.

## **AUDITORS OF MORGAN STANLEY**

Deloitte & Touche LLP  
Two World Financial Center  
New York, New York 10281  
U.S.A.

## **AUDITORS OF MORGAN STANLEY (JERSEY) LIMITED**

Deloitte & Touche  
PO Box 403  
66-68 Esplanade  
St Helier  
JE4 8WA  
Jersey

## **AUDITORS OF MORGAN STANLEY B.V.**

Deloitte Accountants B.V.  
Orlyplein 50  
1043 DP Amsterdam  
The Netherlands

**Annex A**

**Morgan Stanley's Quarterly Report on Form 10-Q  
for the quarterly period ended 31 May 2006**

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

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**FORM 10-Q**

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

For the quarterly period ended May 31, 2006

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-11758

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

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**Delaware**  
(State of Incorporation)

**36-3145972**  
(I.R.S. Employer Identification No.)

**1585 Broadway**  
**New York, NY**  
(Address of Principal  
Executive Offices)

**10036**  
(Zip Code)

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

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

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

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-Accelerated Filer ☐

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

As of June 30, 2006, there were 1,071,959,235 shares of the Registrant's Common Stock, par value \$.01 per share, outstanding.

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**MORGAN STANLEY**  
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**Quarter Ended May 31, 2006**

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## AVAILABLE INFORMATION

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

Morgan Stanley’s internet site is [www.morganstanley.com](http://www.morganstanley.com). You can access Morgan Stanley’s Investor Relations webpage through our internet site, [www.morganstanley.com](http://www.morganstanley.com), by clicking on the “About Morgan Stanley” link to the heading “Investor Relations.” You can also access our Investor Relations webpage directly at [www.morganstanley.com/about/ir](http://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 our 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 Morgan Stanley’s Corporate Governance webpage through our internet site, [www.morganstanley.com](http://www.morganstanley.com), by clicking on the “About Morgan Stanley” link to the heading “Inside the Company.” You can also access our Corporate Governance webpage directly at [www.morganstanley.com/about/inside/governance](http://www.morganstanley.com/about/inside/governance). Morgan Stanley posts the following on its Corporate Governance webpage:

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

You can request a copy of these documents, excluding exhibits, at no cost, by contacting Investor Relations, 1585 Broadway, New York, NY 10036 (212-761-4000). The information on Morgan Stanley’s internet site is not incorporated by reference into this report.

**Item 1.**

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

	May 31, 2006	November 30, 2005
	(unaudited)	
<b>Assets</b>		
Cash and cash equivalents .....	\$ 14,793	\$ 29,414
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements (including securities at fair value of \$26,979 at May 31, 2006 and \$30,223 at November 30, 2005) .....	46,612	40,130
Financial instruments owned (approximately \$104 billion and \$93 billion were pledged to various parties at May 31, 2006 and November 30, 2005, respectively):		
U.S. government and agency securities .....	33,781	31,742
Other sovereign government obligations .....	24,484	22,750
Corporate and other debt .....	128,358	105,381
Corporate equities .....	69,215	52,238
Derivative contracts .....	51,536	45,894
Physical commodities .....	2,797	2,610
Total financial instruments owned .....	310,171	260,615
Securities received as collateral .....	61,248	43,557
Collateralized agreements:		
Securities purchased under agreements to resell .....	190,289	174,330
Securities borrowed .....	274,581	244,241
Receivables:		
Consumer loans (net of allowances of \$776 at May 31, 2006 and \$838 at November 30, 2005) .....	21,965	22,916
Customers .....	67,878	50,979
Brokers, dealers and clearing organizations .....	6,785	5,030
Fees, interest and other .....	9,328	6,137
Office facilities, at cost (less accumulated depreciation of \$3,435 at May 31, 2006 and \$3,196 at November 30, 2005) .....	2,809	2,733
Aircraft held for sale .....	—	3,145
Goodwill and net intangible assets .....	2,932	2,500
Other assets .....	17,652	12,796
Total assets .....	<u>\$1,027,043</u>	<u>\$898,523</u>

**MORGAN STANLEY**

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

	May 31, 2006	November 30, 2005
	(unaudited)	
<b>Liabilities and Shareholders' Equity</b>		
Commercial paper and other short-term borrowings	\$ 34,028	\$ 31,120
Deposits	22,560	18,663
Financial instruments sold, not yet purchased:		
U.S. government and agency securities	19,594	20,425
Other sovereign government obligations	29,507	25,355
Corporate and other debt	7,788	5,480
Corporate equities	52,292	45,936
Derivative contracts	48,747	44,952
Physical commodities	1,894	4,852
Total financial instruments sold, not yet purchased	159,822	147,000
Obligation to return securities received as collateral	61,248	43,557
Collateralized financings:		
Securities sold under agreements to repurchase	257,250	237,274
Securities loaned	141,454	120,454
Other secured financings	28,798	23,534
Payables:		
Customers	131,413	112,246
Brokers, dealers and clearing organizations	6,478	4,789
Interest and dividends	5,528	3,338
Other liabilities and accrued expenses	18,158	16,835
Long-term borrowings	127,985	110,465
	994,722	869,275
Capital Units	66	66
Commitments and contingencies		
Shareholders' equity:		
Common stock, \$0.01 par value;		
Shares authorized: 3,500,000,000 at May 31, 2006 and November 30, 2005;		
Shares issued: 1,211,701,552 at May 31, 2006 and November 30, 2005;		
Shares outstanding: 1,071,786,172 at May 31, 2006 and 1,057,677,994 at		
November 30, 2005	12	12
Paid-in capital	1,670	2,389
Retained earnings	38,125	35,185
Employee stock trust	4,726	3,060
Accumulated other comprehensive income (loss)	20	(190)
Common stock held in treasury, at cost, \$0.01 par value;		
139,915,380 shares at May 31, 2006 and 154,023,558 shares at		
November 30, 2005	(7,572)	(8,214)
Common stock issued to employee trust	(4,726)	(3,060)
Total shareholders' equity	32,255	29,182
Total liabilities and shareholders' equity	\$1,027,043	\$898,523

See Notes to Condensed Consolidated Financial Statements.



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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
	(unaudited)		(unaudited)	
Revenues:				
Investment banking .....	\$ 1,132	\$ 814	\$ 2,114	\$ 1,635
Principal transactions:				
Trading .....	3,735	1,794	6,802	3,640
Investments .....	690	226	1,004	379
Commissions .....	1,005	824	1,934	1,648
Fees:				
Asset management, distribution and administration .....	1,333	1,246	2,612	2,450
Merchant, cardmember and other .....	277	318	566	626
Servicing and securitization income .....	651	423	1,247	917
Interest and dividends .....	10,114	6,035	20,663	11,878
Other .....	125	121	239	226
Total revenues .....	19,062	11,801	37,181	23,399
Interest expense .....	9,988	5,561	19,469	10,186
Provision for consumer loan losses .....	130	209	285	344
Net revenues .....	8,944	6,031	17,427	12,869
Non-interest expenses:				
Compensation and benefits .....	3,723	2,622	7,906	5,476
Occupancy and equipment .....	237	232	469	564
Brokerage, clearing and exchange fees .....	340	276	632	536
Information processing and communications .....	365	349	712	691
Marketing and business development .....	298	298	536	555
Professional services .....	538	438	972	817
Other .....	267	422	577	992
September 11 <sup>th</sup> related insurance recoveries, net .....	—	—	—	(251)
Total non-interest expenses .....	5,768	4,637	11,804	9,380
Income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net .....	3,176	1,394	5,623	3,489
Losses from unconsolidated investees .....	103	67	172	140
Provision for income taxes .....	1,124	396	1,908	1,069
Income from continuing operations before cumulative effect of accounting change, net .....	1,949	931	3,543	2,280
Discontinued operations:				
Income/(loss) from discontinued operations .....	14	(5)	(42)	2
Income tax (provision)/benefit .....	(6)	2	17	(1)
Income/(loss) on discontinued operations .....	8	(3)	(25)	1
Cumulative effect of accounting change, net .....	—	—	—	49
Net income .....	\$ 1,957	\$ 928	\$ 3,518	\$ 2,330
Earnings per basic share:				
Income from continuing operations .....	\$ 1.92	\$ 0.88	\$ 3.48	\$ 2.15
Income/(loss) on discontinued operations .....	0.01	—	(0.02)	—
Cumulative effect of accounting change, net .....	—	—	—	0.05
Earnings per basic share .....	\$ 1.93	\$ 0.88	\$ 3.46	\$ 2.20
Earnings per diluted share:				
Income from continuing operations .....	\$ 1.85	\$ 0.86	\$ 3.35	\$ 2.10
Income/(loss) on discontinued operations .....	0.01	—	(0.02)	—
Cumulative effect of accounting change, net .....	—	—	—	0.05
Earnings per diluted share .....	\$ 1.86	\$ 0.86	\$ 3.33	\$ 2.15
Average common shares outstanding:				
Basic .....	1,013,241,715	1,053,812,487	1,016,756,096	1,061,632,036
Diluted .....	1,054,733,745	1,079,811,172	1,056,493,761	1,084,988,764

See Notes to Condensed Consolidated Financial Statements.

**MORGAN STANLEY**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(dollars in millions)

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
	(unaudited)		(unaudited)	
Net income .....	\$1,957	\$928	\$3,518	\$2,330
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments .....	97	(41)	130	(45)
Net change in cash flow hedges .....	53	(56)	80	(50)
Comprehensive income .....	<u>\$2,107</u>	<u>\$831</u>	<u>\$3,728</u>	<u>\$2,235</u>

See Notes to Condensed Consolidated Financial Statements.

**MORGAN STANLEY**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(dollars in millions)

	Six Months Ended May 31,	
	2006	2005
	(unaudited)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 3,518	\$ 2,330
Adjustments to reconcile net income to net cash used for operating activities:		
Cumulative effect of accounting change, net	—	(49)
Compensation payable in common stock and options	1,067	408
Depreciation and amortization	365	478
Provision for consumer loan losses	285	344
Lease adjustment	—	109
Insurance settlement	—	(251)
Aircraft-related charges	125	—
Changes in assets and liabilities:		
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements	(6,482)	(12,636)
Financial instruments owned, net of financial instruments sold, not yet purchased	(36,391)	(11,695)
Securities borrowed, net of securities loaned	(9,340)	(3,245)
Receivables and other assets	(23,664)	8,057
Payables and other liabilities	24,899	10,386
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell	4,017	(25,023)
Net cash used for operating activities	<u>(41,601)</u>	<u>(30,787)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net proceeds from (payments for):		
Office facilities and aircraft under operating leases	1,990	(270)
Purchase of Goldfish	(1,676)	—
Purchase of PULSE, net of cash acquired	—	(279)
Net principal disbursed on consumer loans	(6,371)	(4,813)
Sales of consumer loans	8,359	4,954
Sale of interest in POSIT	—	90
Insurance settlement	—	220
Net cash provided by (used for) investing activities	<u>2,302</u>	<u>(98)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net proceeds from (payments for):		
Short-term borrowings	2,908	3,754
Derivatives financing activities	(156)	993
Other secured financings	5,264	9,315
Deposits	3,897	2,476
Tax benefits associated with stock-based awards	39	261
Net proceeds from:		
Issuance of common stock	229	253
Issuance of long-term borrowings	25,693	15,768
Payments for:		
Repayments of long-term borrowings	(11,306)	(6,788)
Repurchases of common stock	(1,312)	(2,276)
Cash dividends	(578)	(596)
Net cash provided by financing activities	<u>24,678</u>	<u>23,160</u>
Net decrease in cash and cash equivalents	(14,621)	(7,725)
Cash and cash equivalents, at beginning of period	29,414	32,811
Cash and cash equivalents, at end of period	<u>\$ 14,793</u>	<u>\$ 25,086</u>

See Notes to Condensed Consolidated Financial Statements.

**MORGAN STANLEY**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Introduction and Basis of Presentation.**

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

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

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

*Asset Management* provides global asset management products and services in equities, fixed income and alternative investment products through three principal distribution channels: a proprietary channel consisting of the Company’s representatives; a non-proprietary channel consisting of third-party broker-dealers, banks, financial planners and other intermediaries; and the Company’s institutional sales channel; and engages in investment activities.

*Discover* offers Discover®-branded credit cards and other consumer products and services, and includes the operations of Discover Network, which operates a merchant and cash access network for Discover Network branded cards, and PULSE EFT Association LP (“PULSE”), an automated teller machine/debit and electronic funds transfer network. The Discover business segment also includes consumer finance products and services in the U.K., including Morgan Stanley-branded, Goldfish-branded and various other credit cards issued on the MasterCard network.

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

The condensed consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest. The Company’s policy is to consolidate all entities in which it owns more than 50% of the outstanding voting stock unless it does not control the entity. The Company also consolidates any variable interest entities for which it is deemed to be the primary beneficiary (see Note 11). For investments in companies in which the Company has significant influence over operating and financial decisions (generally defined as owning a voting or economic interest of 20% to 50%), the Company applies the equity method of accounting.

The Company’s U.S. and international subsidiaries include Morgan Stanley & Co. Incorporated (“MS&Co.”), Morgan Stanley & Co. International Limited (“MSIL”), Morgan Stanley Japan Securities Co., Ltd. (“MSJS”), Morgan Stanley DW Inc. (“MSDWT”), Morgan Stanley Investment Advisors Inc. and NOVUS Credit Services Inc.

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Certain reclassifications have been made to prior-period amounts to conform to the current period's presentation. All material intercompany balances and transactions have been eliminated.

The condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2005 (the "Form 10-K"). The condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for the fair statement of the results for the interim period. The results of operations for interim periods are not necessarily indicative of results for the entire year.

**Discontinued Operations.** The Company's aircraft leasing business was classified as "held for sale" prior to its sale on March 24, 2006, and associated revenues and expenses have been reported as discontinued operations for all periods presented. Prior to being reclassified as discontinued operations, the results of the Company's aircraft leasing business were included in the Institutional Securities business segment. See Note 15 for additional information on discontinued operations.

#### **Revenue Recognition.**

**Investment Banking.** Underwriting revenues and fees for mergers, acquisitions and advisory assignments are recorded when services for the transactions are determined to be completed, generally as set forth under the terms of the engagement. Transaction-related expenses, primarily consisting of legal, travel and other costs directly associated with the transaction, are deferred and recognized in the same period as the related investment banking transaction revenue. Underwriting revenues are presented net of related expenses. Non-reimbursed expenses associated with advisory transactions are recorded within Non-interest expenses.

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

**Asset Management, Distribution and Administration Fees.** Asset management, distribution and administration fees are recognized over the relevant contract period, generally quarterly or annually. In certain management fee arrangements, the Company is entitled to receive performance fees when the return on assets under management exceeds certain benchmark returns or other performance targets. Performance fee revenue is accrued quarterly based on measuring account/fund performance to date versus the performance benchmark stated in the investment management agreement.

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

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

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

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

*Financial Instruments Used for Trading and Investment.* Financial instruments owned and Financial instruments sold, not yet purchased, which include cash and derivative products, are recorded at fair value in the condensed consolidated statements of financial condition, and gains and losses are reflected net in Principal transaction trading and investment revenues in the condensed consolidated statements of income. Loans and lending commitments associated with the Company's corporate lending activities also are primarily recorded at fair value. Fair value is the amount at which financial instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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

A substantial percentage of the fair value of the Company's Financial instruments owned and Financial instruments sold, not yet purchased is based on observable market prices, observable market parameters, or is derived from such prices or parameters. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing parameters in a product (or a related product) may be used to derive a price without requiring significant judgment. In certain markets, observable market prices or market parameters are not available for all products, and fair value is determined using techniques appropriate for each particular product. These techniques involve some degree of judgment. The price transparency of the particular product will determine the degree of judgment involved in determining the fair value of the Company's financial instruments. Price transparency is affected by a wide variety of factors, including, for example, the type of product, whether it is a new product and not yet established in the marketplace, and the characteristics particular to the transaction. Products for which actively quoted prices or pricing parameters are available or for which fair value is derived from actively quoted prices or pricing parameters will generally have a higher degree of price transparency. By contrast, products that are thinly traded or not quoted will generally have reduced to no price transparency.

The fair value of over-the-counter ("OTC") derivative contracts is derived primarily using pricing models, which may require multiple market input parameters. Where appropriate, valuation adjustments are made to account for

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Purchases and sales of financial instruments and related expenses are recorded in the accounts on trade date. Unrealized gains and losses arising from the Company's dealings in OTC financial instruments, including derivative contracts related to financial instruments and commodities, are presented in the accompanying condensed consolidated statements of financial condition on a net-by-counterparty basis, when appropriate.

The Company nets cash collateral paid or received against its derivatives inventory under credit support annexes, which the Company views as conditional contracts, to legally enforceable master netting agreements.

Equity and debt securities purchased in connection with private equity and other principal investment activities initially are carried in the condensed consolidated financial statements at their original costs, which approximate fair value. The carrying value of such securities is adjusted when changes in the underlying fair values are readily ascertainable, generally as evidenced by observable market prices or transactions that directly affect the value of such securities. Downward adjustments relating to such securities are made in the event that the Company determines that the fair value is less than the carrying value. The Company's partnership interests, including general partnership and limited partnership interests in real estate funds, are included within Other assets in the condensed consolidated statements of financial condition and are recorded at fair value based upon changes in the fair value of the underlying partnership's net assets.

*Financial Instruments Used for Asset and Liability Management.* The Company enters into various derivative financial instruments for non-trading purposes. These instruments are included within Financial instruments owned—derivative contracts or Financial instruments sold, not yet purchased—derivative contracts within the condensed consolidated statements of financial condition and include interest rate swaps, foreign currency swaps, equity swaps and foreign exchange forwards. The Company uses interest rate and currency swaps and equity derivatives to manage interest rate, currency and equity price risk arising from certain liabilities. The Company also utilizes interest rate swaps to match the repricing characteristics of consumer loans with those of the borrowings that fund these loans. Certain of these derivative financial instruments are designated and qualify as fair value hedges, which hedge the changes in fair value of assets, liabilities or firm commitments and cash flow hedges, which hedge the variability of future cash flows from forecasted transactions and floating rate assets and liabilities.

The Company's designated fair value hedges consist primarily of hedges of fixed rate borrowings, including fixed rate borrowings that fund consumer loans.

For qualifying fair value hedges, the changes in the fair value of the derivative and the gain or loss on the hedged asset or liability relating to the risk being hedged are recorded currently in earnings. These amounts are recorded in Interest expense and provide offset of one another. For qualifying cash flow hedges, the changes in the fair



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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

value of the derivative are recorded in Accumulated other comprehensive income (loss) in Shareholders' equity, net of tax effects, and amounts in Accumulated other comprehensive income (loss) are reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Ineffectiveness relating to fair value and cash flow hedges, if any, is recorded within Interest expense. The impact of hedge ineffectiveness on the condensed consolidated statements of income was not material for all periods presented.

In connection with the sale of the aircraft financing business (see Note 15), the Company de-designated the interest rate swaps associated with this business effective August 31, 2005 and no longer accounts for them as cash flow hedges. Amounts in Accumulated other comprehensive income (loss) related to those interest rate swaps, which were designated as hedges of the Company's variable rate long-term borrowings, are being reclassified to earnings when the hedged forecasted transactions impact earnings, as these transactions are still probable of occurring.

The Company also utilizes foreign exchange forward contracts to manage the currency exposure relating to its net monetary investments in non-U.S. dollar functional currency operations. The gain or loss from revaluing these contracts is deferred and reported within Accumulated other comprehensive income (loss) in Shareholders' equity, net of tax effects, with the related unrealized amounts due from or to counterparties included in Financial instruments owned or Financial instruments sold, not yet purchased. The interest elements (forward points) on these foreign exchange forward contracts are recorded in earnings.

*Securitization Activities.* The Company engages in securitization activities related to commercial and residential mortgage loans, corporate bonds and loans, U.S. agency collateralized mortgage obligations, credit card loans and other types of financial assets (see Notes 3 and 4). The Company may retain interests in the securitized financial assets as one or more tranches of the securitization, undivided seller's interests, accrued interest receivable subordinate to investors' interests (see Note 4), cash collateral accounts, servicing rights, rights to any excess cash flows remaining after payments to investors in the securitization trusts of their contractual rate of return and reimbursement of credit losses, and other retained interests. The exposure to credit losses from securitized loans is limited to the Company's retained contingent risk, which represents the Company's retained interest in securitized loans, including any credit enhancement provided. The gain or loss on the sale of financial assets depends in part on the previous carrying amount of the assets involved in the transfer, and each subsequent transfer in revolving structures, allocated between the assets sold and the retained interests based upon their respective fair values at the date of sale. To obtain fair values, observable market prices are used if available. However, observable market prices are generally not available for retained interests so the Company estimates fair value based on the present value of expected future cash flows using its best estimates of the key assumptions, including forecasted credit losses, payment rates, forward yield curves and discount rates commensurate with the risks involved. The present value of future net excess cash flows that the Company estimates it will receive over the term of the securitized loans is recognized in income as the loans are securitized. A corresponding asset also is recorded and charged to income over the term of the securitized loans, with actual net excess cash flows continuing to be recognized in income as they are earned.

*Stock-Based Compensation.* The Company early adopted Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment," using the modified prospective approach as of December 1, 2004. SFAS No. 123R revised the fair value-based method of accounting for share-based payment liabilities, forfeitures and modifications of stock-based awards and clarified guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to service periods. Upon adoption, the Company recognized an \$80 million gain (\$49 million after-tax) as a cumulative effect of a change in accounting principle in the first quarter of fiscal 2005 resulting from the requirement to estimate forfeitures at the date of grant instead of recognizing them as incurred. The cumulative effect gain increased both basic and diluted earnings per share by \$0.05.



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### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

For stock-based awards issued prior to the adoption of SFAS No. 123R, the Company's accounting policy for awards granted to retirement-eligible employees was to recognize compensation cost over the service period specified in the award terms. The Company accelerates any unrecognized compensation cost for such awards if and when a retirement-eligible employee leaves the Company. For stock-based awards made to retirement-eligible employees during fiscal 2005, the Company recognized compensation expense for such awards on the date of grant.

For fiscal 2005 year-end stock-based compensation awards that were granted to retirement-eligible employees in December 2005, the Company recognized the compensation cost for such awards at the date of grant instead of over the service period specified in the award terms. As a result, the Company recorded non-cash incremental compensation expenses of approximately \$395 million in the first quarter of fiscal 2006 for stock-based awards granted to retirement-eligible employees as part of the fiscal 2005 year-end award process and for awards granted to retirement-eligible employees, including new hires, in the first quarter of fiscal 2006. These incremental expenses were included within Compensation and benefits expense and reduced income before taxes within the Institutional Securities (\$270 million), Global Wealth Management Group (\$80 million), Asset Management (\$28 million) and Discover (\$17 million) business segments.

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 will be 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 (currently scheduled to occur in December 2006). The Company believes that this method of recognition for retirement-eligible employees is preferable because it better reflects the period over which the compensation is earned.

If the Company had accrued the estimated cost of equity awards granted to retirement-eligible employees over the course of the fiscal year ended November 30, 2005 rather than expensing such awards at the grant date in December 2005, net income would have decreased for the quarter and six month period ended May 31, 2005. The approximate resulting pro forma net income would have been \$860 million and \$2,198 million, respectively, rather than the reported amounts of \$928 million and \$2,330 million, respectively. The approximate resulting impact on earnings per share for the quarter ended May 31, 2005 would have been a reduction in the reported amounts of earnings per basic share from \$0.88 to \$0.82 and earnings per diluted share from \$0.86 to \$0.80. The approximate resulting impact on earnings per share for the six month period ended May 31, 2005 would have been a reduction in the reported amounts of earnings per basic share from \$2.20 to \$2.07 and earnings per diluted share from \$2.15 to \$2.03.

#### **2. Goodwill and Intangible Assets.**

During the first quarter of fiscal 2006, the Company completed the annual goodwill impairment test (as of December 1 in each fiscal year). The Company's testing did not indicate any goodwill impairment.

# MORGAN STANLEY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Changes in the carrying amount of the Company's goodwill and intangible assets for the six month period ended May 31, 2006 were as follows:

	<u>Institutional Securities</u>	<u>Global Wealth Management Group</u>	<u>Asset Management</u>	<u>Discover</u>	<u>Total</u>
	(dollars in millions)				
<b>Goodwill:</b>					
<b>Balance as of November 30, 2005</b> .....	\$444	\$540	\$966	\$256	\$2,206
Translation adjustments .....	—	30	—	16	46
Goodwill acquired during the period(1) .....	<u>2</u>	<u>—</u>	<u>2</u>	<u>232</u>	<u>236</u>
<b>Balance as of May 31, 2006</b> .....	<u>\$446</u>	<u>\$570</u>	<u>\$968</u>	<u>\$504</u>	<u>\$2,488</u>
<b>Intangible assets:</b>					
<b>Balance as of November 30, 2005</b> .....	\$227	\$—	\$—	\$ 67	\$ 294
Intangible assets acquired during the period(1) ....	26	—	4	128	158
Translation adjustments .....	—	—	—	10	10
Amortization expense .....	<u>(13)</u>	<u>—</u>	<u>—</u>	<u>(5)</u>	<u>(18)</u>
<b>Balance as of May 31, 2006</b> .....	<u>\$240</u>	<u>\$—</u>	<u>\$ 4</u>	<u>\$200</u>	<u>\$ 444</u>

(1) Discover activity represents goodwill and intangible assets acquired in connection with the Company's acquisition of Goldfish (see Note 16).

### 3. Collateralized and Securitization Transactions.

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

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

	<u>At May 31, 2006</u>	<u>At November 30, 2005</u>
	(dollars in millions)	
<b>Financial instruments owned:</b>		
U.S. government and agency securities .....	\$13,519	\$12,494
Other sovereign government obligations .....	155	328
Corporate and other debt .....	35,387	21,775
Corporate equities .....	<u>5,837</u>	<u>5,290</u>
<b>Total</b> .....	<u>\$54,898</u>	<u>\$39,887</u>

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company enters into reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions to, among other things, acquire securities to cover short positions and settle other securities obligations, to accommodate customers' needs and to finance the Company's inventory positions. The Company also engages in securities financing transactions for customers through margin lending. Under these agreements and transactions, the Company either receives or provides collateral, including U.S. government and agency securities, other sovereign government obligations, corporate and other debt, and corporate equities. The Company receives collateral in the form of securities in connection with reverse repurchase agreements, securities borrowed transactions and customer margin loans. In many cases, the Company is permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements, to enter into securities lending transactions or for delivery to counterparties to cover short positions. At May 31, 2006 and November 30, 2005, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was \$909 billion and \$798 billion, respectively, and the fair value of the portion that has been sold or repledged was \$801 billion and \$737 billion, respectively.

The Company manages credit exposure arising from reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions by, in appropriate circumstances, entering into master netting agreements and collateral arrangements with counterparties that provide the Company, in the event of a customer default, the right to liquidate collateral and the right to offset a counterparty's rights and obligations. The Company also monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralized. Where deemed appropriate, the Company's agreements with third parties specify its rights to request additional collateral. Customer receivables generated from margin lending activity are collateralized by customer-owned securities held by the Company. For these transactions, adherence to the Company's collateral policies significantly limits the Company's credit exposure in the event of customer default. The Company may request additional margin collateral from customers, if appropriate, and if necessary may sell securities that have not been paid for or purchase securities sold, but not delivered from customers.

In connection with its Institutional Securities business, the Company engages in securitization activities related to residential and commercial mortgage loans, U.S. agency collateralized mortgage obligations, corporate bonds and loans, and other types of financial assets. These assets are carried at fair value, and any changes in fair value are recognized in the condensed consolidated statements of income. The Company may act as underwriter of the beneficial interests issued by securitization vehicles. Underwriting net revenues are recognized in connection with these transactions. The Company may retain interests in the securitized financial assets as one or more tranches of the securitization. These retained interests are included in the condensed consolidated statements of financial condition at fair value. Any changes in the fair value of such retained interests are recognized in the condensed consolidated statements of income. Retained interests in securitized financial assets associated with the Institutional Securities business were approximately \$3.7 billion at May 31, 2006, the majority of which were related to residential mortgage loan, U.S. agency collateralized mortgage obligation and commercial mortgage loan securitization transactions. Net gains at the time of securitization were not material in the six month period ended May 31, 2006. The assumptions that the Company used to determine the fair value of its retained interests at the time of securitization related to those transactions that occurred during the quarter and six month period ended May 31, 2006 were not materially different from the assumptions included in the table below. Additionally, as indicated in the table below, the Company's exposure to credit losses related to these retained interests was not material to the Company's results of operations.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table presents information on the Company's residential mortgage loan, U.S. agency collateralized mortgage obligation and commercial mortgage loan securitization transactions. Key economic assumptions and the sensitivity of the current fair value of the retained interests to immediate 10% and 20% adverse changes in those assumptions at May 31, 2006 were as follows (dollars in millions):

	<b>Residential Mortgage Loans</b>	<b>U.S. Agency Collateralized Mortgage Obligations</b>	<b>Commercial Mortgage Loans</b>
Retained interests (carrying amount/fair value) . . . . .	\$ 2,594	\$ 865	\$ 173
Weighted average life (in months) . . . . .	38	113	60
Credit losses (rate per annum) . . . . .	0.00-4.25%	—	0.00-5.06%
Impact on fair value of 10% adverse change . . . . .	\$ (92)	\$ —	\$ (1)
Impact on fair value of 20% adverse change . . . . .	\$ (174)	\$ —	\$ (2)
Weighted average discount rate (rate per annum) . . . . .	9.00%	6.26%	8.10%
Impact on fair value of 10% adverse change . . . . .	\$ (44)	\$ (29)	\$ (4)
Impact on fair value of 20% adverse change . . . . .	\$ (88)	\$ (56)	\$ (7)
Prepayment speed assumption(1)(2) . . . . .	318-2833PSA	131-242PSA	—
Impact on fair value of 10% adverse change . . . . .	\$ (43)	\$ (4)	\$ —
Impact on fair value of 20% adverse change . . . . .	\$ (50)	\$ (7)	\$ —

(1) Amounts for residential mortgage loans exclude positive valuation effects from immediate 10% and 20% changes.

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

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

In connection with its Institutional Securities business, during the six month periods ended May 31, 2006 and 2005, the Company received proceeds from new securitization transactions of \$31.0 billion and \$34.5 billion, respectively, and cash flows from retained interests in securitization transactions of \$2,843 million and \$3,655 million, respectively.

**4. Consumer Loans.**

Consumer loans were as follows:

	<b>At May 31, 2006</b>	<b>At November 30, 2005</b>
	<b>(dollars in millions)</b>	
General purpose credit card, mortgage and consumer installment . . . . .	\$22,741	\$23,754
Less:		
Allowance for consumer loan losses . . . . .	776	838
Consumer loans, net . . . . .	<u>\$21,965</u>	<u>\$22,916</u>

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005(1)	2006	2005(1)
	(dollars in millions)			
Balance at beginning of period	\$ 785	\$ 854	\$ 838	\$ 943
Additions:				
Provision for consumer loan losses	130	209	285	344
Purchase of consumer loans(2)	9	—	53	—
Deductions:				
Charge-offs	(192)	(261)	(492)	(521)
Recoveries	42	40	89	76
Net charge-offs	(150)	(221)	(403)	(445)
Translation adjustments and other	2	(2)	3	(2)
Balance at end of period	<u>\$ 776</u>	<u>\$ 840</u>	<u>\$ 776</u>	<u>\$ 840</u>

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

(2) Amounts relate to the Company's acquisition of Goldfish (see Note 16).

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
	(dollars in millions)			
Interest accrued on general purpose credit card loans subsequently charged off, net of recoveries (recorded as a reduction of Interest revenue)	<u>\$44</u>	<u>\$50</u>	<u>\$82</u>	<u>\$106</u>
Cardmember fees accrued on general purpose credit card loans subsequently charged off, net of recoveries (recorded as a reduction to Merchant, cardmember and other fee revenue)	<u>\$23</u>	<u>\$27</u>	<u>\$45</u>	<u>\$ 60</u>

At May 31, 2006, the Company had commitments to extend credit for consumer loans of approximately \$273 billion. Such commitments arise primarily from agreements with customers for unused lines of credit on certain credit cards, provided there is no violation of conditions established in the related agreement. These commitments, substantially all of which the Company can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage and customer creditworthiness.

At May 31, 2006 and November 30, 2005, \$874 million and \$4,080 million, respectively, of the Company's consumer loans were classified as held for sale.

The Company received net proceeds from consumer loan sales of \$1,349 million and \$8,359 million in the quarter and six month period ended May 31, 2006 and \$262 million and \$4,954 million in the quarter and six month period ended May 31, 2005.

**Credit Card Securitization Activities.** The Company's retained interests in credit card asset securitizations include undivided seller's interests, accrued interest receivable on securitized credit card receivables, cash collateral accounts, servicing rights, rights to any excess cash flows ("Residual Interests") remaining after

# MORGAN STANLEY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

payments to investors in the securitization trusts of their contractual rate of return and reimbursement of credit losses, and other retained interests. The undivided seller's interests less an applicable allowance for loan losses is recorded in Consumer loans. The Company's undivided seller's interests rank *pari passu* with investors' interests in the securitization trusts, and the remaining retained interests are subordinate to investors' interests. Accrued interest receivable and certain other subordinated retained interests are recorded in Other assets at amounts that approximate fair value. The Company receives annual servicing fees of 2% of the investor principal balance outstanding. The Company does not recognize servicing assets or servicing liabilities for servicing rights since the servicing contracts provide just adequate compensation (as defined in SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities") to the Company for performing the servicing. Residual Interests and cash collateral accounts are recorded in Other assets and reflected at fair value with changes in fair value recorded currently in earnings. At May 31, 2006, the Company had \$10,255 million of retained interests, including \$6,869 million of undivided seller's interests, in credit card asset securitizations. The retained interests are subject to credit, payment and interest rate risks on the transferred credit card assets. The investors and the securitization trusts have no recourse to the Company's other assets for failure of cardmembers to pay when due.

During the six month periods ended May 31, 2006 and 2005, the Company completed credit card asset securitizations of \$6.6 billion and \$3.4 billion, respectively, and recognized net securitization gains of \$156 million and \$16 million, respectively, as servicing and securitization income in the condensed consolidated statements of income. The amount for the six month period ended May 31, 2006 includes an increase in the fair value of the Company's retained interests in securitized credit card receivables primarily resulting from a favorable impact on charge-offs following the enactment of federal bankruptcy legislation that became effective in October 2005. The uncollected balances of securitized general purpose credit card loans were \$26.8 billion and \$24.4 billion at May 31, 2006 and November 30, 2005, respectively.

Key economic assumptions used in measuring the Residual Interests at the date of securitization resulting from credit card asset securitizations completed during the six month periods ended May 31, 2006 and 2005 were as follows:

	Six Months Ended May 31,	
	2006	2005
Weighted average life (in months) . . . . .	3.7 - 4.7	5.9
Payment rate (rate per month) . . . . .	19.69% - 21.34%	18.52%
Credit losses (rate per annum) . . . . .	4.72% - 5.23%	6.00%
Discount rate (rate per annum) . . . . .	11.00%	12.00%

**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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

	<u>At May 31, 2006</u>
Residual Interests (carrying amount/fair value) . . . . .	\$ 338
Weighted average life (in months) . . . . .	4.3
Weighted average payment rate (rate per month) . . . . .	21.58%
Impact on fair value of 10% adverse change . . . . .	\$ (25)
Impact on fair value of 20% adverse change . . . . .	\$ (46)
Weighted average credit losses (rate per annum) . . . . .	4.46%
Impact on fair value of 10% adverse change . . . . .	\$ (39)
Impact on fair value of 20% adverse change . . . . .	\$ (78)
Weighted average discount rate (rate per annum) . . . . .	11.00%
Impact on fair value of 10% adverse change . . . . .	\$ (1)
Impact on fair value of 20% adverse change . . . . .	\$ (3)

The sensitivity analysis in the table above is hypothetical and should be used with caution. Changes in fair value based on a 10% or 20% variation in an assumption generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the Residual Interests is calculated independent of changes in any other assumption; in practice, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower payments and increased credit losses), which might magnify or counteract the sensitivities. In addition, the sensitivity analysis does not consider any corrective action that the Company may take to mitigate the impact of any adverse changes in the key assumptions.

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

	<u>Six Months Ended May 31,</u>	
	<u>2006</u>	<u>2005</u>
Proceeds from new credit card asset securitizations . . . . .	\$ 6.6	\$ 3.4
Proceeds from collections reinvested in previous credit card asset securitizations . . . . .	\$29.6	\$29.1
Contractual servicing fees received . . . . .	\$ 0.3	\$ 0.3
Cash flows received from retained interests . . . . .	\$ 1.1	\$ 1.0

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

	<u>At May 31, 2006</u>		<u>Six Months Ended May 31, 2006</u>	
	<u>Loans Outstanding</u>	<u>Loans Delinquent</u>	<u>Average Loans</u>	<u>Net Principal Credit Losses</u>
Managed general purpose credit card loans . . . . .	\$48,539	\$1,599	\$47,439	\$992
Less: Securitized general purpose credit card loans . . . . .	<u>26,775</u>			
Owned general purpose credit card loans . . . . .	<u>\$21,764</u>			



## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### 5. Long-Term Borrowings.

Long-term borrowings at May 31, 2006 scheduled to mature within one year aggregated \$14,631 million.

During the six month period ended May 31, 2006, the Company issued senior notes aggregating \$26,454 million, including non-U.S. dollar currency notes aggregating \$11,530 million and \$889 million of junior subordinated debentures. Maturities in the aggregate of these notes by fiscal year are as follows: 2006, \$3 million; 2007, \$2,501 million; 2008, \$5,351 million; 2009, \$3,308 million; 2010, \$1,012 million; and thereafter, \$14,279 million. In the six month period ended May 31, 2006, \$11,306 million of senior notes were repaid.

The weighted average maturity of the Company's long-term borrowings, based upon stated maturity dates, was approximately five years at May 31, 2006.

#### 6. Shareholders' Equity.

**Regulatory Requirements.** MS&Co. and MSDWI are registered broker-dealers and registered futures commission merchants and, accordingly, are subject to the minimum net capital requirements of the Securities and Exchange Commission (the "SEC"), the New York Stock Exchange, Inc. (the "NYSE") and the Commodity Futures Trading Commission. MS&Co. and MSDWI have consistently operated in excess of these requirements. MS&Co.'s net capital totaled \$4,762 million at May 31, 2006, which exceeded the amount required by \$3,721 million. MSDWI's net capital totaled \$1,210 million at May 31, 2006, which exceeded the amount required by \$1,136 million. MSIL, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Authority, and MSJS, a Tokyo-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Agency. MSIL and MSJS have consistently operated in excess of their respective regulatory capital requirements.

Under regulatory capital requirements adopted by the Federal Deposit Insurance Corporation (the "FDIC") and other bank regulatory agencies, FDIC-insured financial institutions must maintain (a) 3% to 5% of Tier 1 capital, as defined, to average assets ("leverage ratio"), (b) 4% of Tier 1 capital, as defined, to risk-weighted assets ("Tier 1 risk-weighted capital ratio") and (c) 8% of total capital, as defined, to risk-weighted assets ("total risk-weighted capital ratio"). At May 31, 2006, the leverage ratio, Tier 1 risk-weighted capital ratio and total risk-weighted capital ratio of each of the Company's FDIC-insured financial institutions exceeded these regulatory minimums.

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

Effective December 1, 2005, the Company became a consolidated supervised entity ("CSE") as defined by the SEC. As such, the Company is subject to group-wide supervision and examination by the SEC and to minimum capital requirements on a consolidated basis. As of May 31, 2006, the Company was in compliance with the CSE capital requirements.

MS&Co. is required to hold tentative net capital in excess of \$1 billion and net capital in excess of \$500 million in accordance with the market and credit risk standards of Appendix E of Rule 15c3-1. MS&Co. is also required to notify the SEC in the event that its tentative net capital is less than \$5 billion. As of May 31, 2006, MS&Co. had tentative net capital in excess of the minimum and the notification requirements.

**Treasury Shares.** During the six month period ended May 31, 2006, the Company purchased approximately \$1,312 million of its common stock through open market purchases at an average cost of \$59.47 per share.



**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

During the six month period ended May 31, 2005, the Company purchased approximately \$2,276 million of its common stock through a combination of open market purchases and employee purchases at an average cost of \$55.13 per share.

**7. Earnings per Share.**

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
<b>Basic EPS:</b>				
Income from continuing operations before cumulative effect of accounting change, net	\$1,949	\$ 931	\$3,543	\$2,280
Income/(loss) on discontinued operations	8	(3)	(25)	1
Cumulative effect of accounting change, net	—	—	—	49
Net income applicable to common shareholders	<u>\$1,957</u>	<u>\$ 928</u>	<u>\$3,518</u>	<u>\$2,330</u>
Weighted average common shares outstanding	<u>1,013</u>	<u>1,054</u>	<u>1,017</u>	<u>1,062</u>
Earnings per basic share:				
Income from continuing operations	\$ 1.92	\$ 0.88	\$ 3.48	\$ 2.15
Income/(loss) on discontinued operations	0.01	—	(0.02)	—
Cumulative effect of accounting change, net	—	—	—	0.05
Earnings per basic share	<u>\$ 1.93</u>	<u>\$ 0.88</u>	<u>\$ 3.46</u>	<u>\$ 2.20</u>
<b>Diluted EPS:</b>				
Net income applicable to common shareholders	<u>\$1,957</u>	<u>\$ 928</u>	<u>\$3,518</u>	<u>\$2,330</u>
Weighted average common shares outstanding	<u>1,013</u>	<u>1,054</u>	<u>1,017</u>	<u>1,062</u>
Effect of dilutive securities:				
Stock options and restricted stock units	<u>42</u>	<u>26</u>	<u>39</u>	<u>23</u>
Weighted average common shares outstanding and common stock equivalents	<u>1,055</u>	<u>1,080</u>	<u>1,056</u>	<u>1,085</u>
Earnings per diluted share:				
Income from continuing operations	\$ 1.85	\$ 0.86	\$ 3.35	\$ 2.10
Income/(loss) on discontinued operations	0.01	—	(0.02)	—
Cumulative effect of accounting change, net	—	—	—	0.05
Earnings per diluted share	<u>\$ 1.86</u>	<u>\$ 0.86</u>	<u>\$ 3.33</u>	<u>\$ 2.15</u>

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
(shares in millions)				
Number of antidilutive securities (including stock options and restricted stock units) outstanding at end of period	40	97	42	96

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Cash dividends declared per common share were \$0.27 and \$0.54 for the quarters and six month periods ended May 31, 2006 and 2005.

#### 8. Commitments and Contingencies.

**Letters of Credit.** At May 31, 2006 and November 30, 2005, the Company had approximately \$7,585 million and \$6,904 million, respectively, of letters of credit outstanding to satisfy various collateral requirements.

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

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

	At May 31, 2006	At November 30, 2005
	(dollars in millions)	
Investment grade lending commitments .....	\$27,088	\$23,968
Non-investment grade lending commitments .....	8,189	13,066
Total .....	<u>\$35,277</u>	<u>\$37,034</u>

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

The Company has commitments to fund other less liquid investments, including at May 31, 2006, \$496 million in connection with investment activities, \$13,593 million related to secured lending transactions and \$8,550 million related to forward purchase contracts involving mortgage loans. Additionally, the Company has provided and will continue to provide financing, including margin lending and other extensions of credit, to clients that may subject the Company to increased credit and liquidity risks.

At May 31, 2006, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately \$106 billion and \$82 billion, respectively.

**Legal.** In the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or in financial distress. The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company's business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number of reviews, investigations and proceedings has increased in recent years.

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

***Coleman Litigation.*** On May 8, 2003, Coleman (Parent) Holdings Inc. ("CPH") filed a complaint against the Company in the Circuit Court of the Fifteenth Judicial Circuit for Palm Beach County. The complaint relates to the merger between The Coleman Company, Inc. ("Coleman") and Sunbeam, Inc. ("Sunbeam") in 1998. The complaint, as amended, alleges that CPH was induced to agree to the transaction with Sunbeam based on certain financial misrepresentations, and it asserts claims against the Company for aiding and abetting fraud, conspiracy and punitive damages. Shortly before trial, which commenced in April 2005, the trial court granted, in part, a motion for entry of a default judgment against the Company and ordered that portions of CPH's complaint, including those setting forth CPH's primary allegations against the Company, be read to the jury and deemed established for all purposes in the action. In May 2005, the jury returned a verdict in favor of CPH and awarded CPH \$604 million in compensatory damages and \$850 million in punitive damages. On June 23, 2005, the trial court issued a final judgment in favor of CPH in the amount of \$1,578 million, which includes prejudgment interest and excludes certain payments received by CPH in settlement of related claims against others. On June 27, 2005, the Company filed a notice of appeal with the District Court of Appeal for the Fourth District of Florida and posted a supersedeas bond, which automatically stayed execution of the judgment pending appeal. Included in Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements in the condensed consolidated statement of financial condition is \$1,863 million of commercial paper and other securities which have been pledged to obtain the bond which was posted in this matter. The Company filed its initial brief in support of its appeal on December 7, 2005. The Company's appeal seeks to reverse the judgment of the trial court on several grounds and asks that the case be remanded for entry of a judgment in favor of the Company or, in the alternative, for a new trial. On June 28, 2006, the District Court of Appeal for the Fourth District of Florida heard oral argument on the Company's appeal from the judgment of the trial court.

The Company believes, after consultation with outside counsel, that it is probable that the compensatory and punitive damages awards will be overturned on appeal and the case remanded for a new trial. Taking into account the advice of outside counsel, the Company is maintaining a reserve of \$360 million for the Coleman litigation, which it believes to be a reasonable estimate, under SFAS No. 5, of the low end of the range of its probable exposure in the event the judgment is overturned and the case remanded for a new trial. If the compensatory and/or punitive awards are ultimately upheld on appeal, in whole or in part, the Company may incur an additional expense equal to the difference between the amount affirmed on appeal (and post-judgment interest thereon) and the amount of the reserve. While the Company cannot predict with certainty the amount of such additional expense, such additional expense could have a material adverse effect on the condensed consolidated financial condition of the Company and/or the Company's or Institutional Securities operating results for a particular future period, and the upper end of the range could exceed \$1.2 billion.

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

***IPO Allocation Matters.*** In connection with the Company's role as either lead or co-lead underwriter in several initial public offerings ("IPO"), the Company has been exposed to both regulatory and civil proceedings. On January 25, 2005, the Company announced a settlement with the SEC regarding allegations that it violated Rule 101 of Regulation M by attempting to induce certain customers that received shares in IPOs to place purchase orders for additional shares in the aftermarket. Under the terms of the settlement, the Company agreed, without admitting or denying the allegations, to the entry of a judgment enjoining it from violating Rule 101 of Regulation M and the payment of a \$40 million civil penalty. The court approved the settlement on February 4, 2005.

In addition to the above mentioned regulatory matter with the SEC, numerous purported class actions have been filed against certain issuers of IPO securities, certain individual officers of those issuers, the Company and other underwriters of those IPOs, purportedly on behalf of purchasers of stock in the IPOs or the aftermarket. These complaints allege that the Company required customers that 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"). 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.

***Income Taxes.*** For information on contingencies associated with income tax examinations, see Note 17.

#### **9. Derivative Contracts.**

In the normal course of business, the Company enters into a variety of derivative contracts related to financial instruments and commodities. The Company uses these instruments for trading and investment purposes, as well as for asset and liability management. These instruments generally represent future commitments to swap interest payment streams, exchange currencies, or purchase or sell commodities and other financial instruments on specific terms at specified future dates. Many of these products have maturities that do not extend beyond one year, although swaps, options and equity warrants typically have longer maturities. For further discussion of these matters, refer to Note 11 to the consolidated financial statements for the fiscal year ended November 30, 2005, included in the Form 10-K.

The fair value (carrying amount) of derivative instruments represents the amount at which the derivative could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale, and is further described in Note 1. Future changes in interest rates, foreign currency exchange rates or the fair values of the financial instruments, commodities or indices underlying these contracts ultimately may result in cash settlements exceeding fair value amounts recognized in the condensed consolidated statements of financial condition. The amounts in the following table represent the fair value of exchange traded and OTC options and other contracts (including interest rate, foreign exchange, and other forward contracts and swaps) for derivatives for trading and investment and for asset and liability management, net of offsetting positions in situations where netting is appropriate. The asset amounts are not reported net of non-cash collateral, which the Company obtains with respect to certain of these transactions to reduce its exposure to credit losses.

Credit risk with respect to derivative instruments arises from the failure of a counterparty to perform according to the terms of the contract. The Company's exposure to credit risk at any point in time is represented by the fair value of the contracts reported as assets. The Company monitors the creditworthiness of counterparties to these transactions on an ongoing basis and requests additional collateral when deemed necessary. The Company believes the ultimate settlement of the transactions outstanding at May 31, 2006 will not have a material effect on the Company's financial condition.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The Company's derivatives (both listed and OTC) at May 31, 2006 and November 30, 2005 are summarized in the table below, showing the fair value of the related assets and liabilities by product:

<u>Product Type</u>	<u>At May 31, 2006</u>		<u>At November 30, 2005</u>	
	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
	(dollars in millions)			
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts . . . . .	\$18,661	\$11,838	\$17,157	\$13,212
Foreign exchange forward contracts and options . . . . .	8,034	8,053	7,548	7,597
Equity securities contracts (including equity swaps, warrants and options) . . . . .	10,393	15,793	7,290	11,957
Commodity forwards, options and swaps . . . . .	14,448	13,063	13,899	12,186
Total . . . . .	<u>\$51,536</u>	<u>\$48,747</u>	<u>\$45,894</u>	<u>\$44,952</u>

**10. Segment Information.**

The Company structures its segments primarily based upon the nature of the financial products and services provided to customers and the Company's management organization. The Company provides a wide range of financial products and services to its customers in each of its business segments: Institutional Securities, Global Wealth Management Group, Asset Management and Discover. For further discussion of the Company's business segments, see Note 1. Certain reclassifications have been made to prior-period amounts to conform to the current period's presentation.

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

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

**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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

<u>Three Months Ended May 31, 2006</u>	<u>Institutional Securities(1)</u>	<u>Global Wealth Management Group</u>	<u>Asset Management</u>	<u>Discover</u>	<u>Intersegment Eliminations(1)</u>	<u>Total</u>
			(dollars in millions)			
Net revenues excluding net interest . . . . .	\$6,119	\$1,272	\$718	\$ 803	\$ (94)	\$8,818
Net interest . . . . .	(393)	130	5	388	(4)	126
Net revenues . . . . .	<u>\$5,726</u>	<u>\$1,402</u>	<u>\$723</u>	<u>\$1,191</u>	<u>\$ (98)</u>	<u>\$8,944</u>
Income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net . . . . .	\$2,267	\$ 157	\$224	\$ 541	\$ (13)	\$3,176
Losses from unconsolidated investees . . .	103	—	—	—	—	103
Provision for income taxes . . . . .	<u>786</u>	<u>51</u>	<u>89</u>	<u>203</u>	<u>(5)</u>	<u>1,124</u>
Income from continuing operations before cumulative effect of accounting change, net(2) . . . . .	<u>\$1,378</u>	<u>\$ 106</u>	<u>\$135</u>	<u>\$ 338</u>	<u>\$ (8)</u>	<u>\$1,949</u>
<u>Three Months Ended May 31, 2005(3)</u>	<u>Institutional Securities</u>	<u>Global Wealth Management Group</u>	<u>Asset Management</u>	<u>Discover</u>	<u>Intersegment Eliminations</u>	<u>Total</u>
			(dollars in millions)			
Net revenues excluding net interest . . . . .	\$3,300	\$1,149	\$641	\$ 534	\$ (67)	\$5,557
Net interest . . . . .	40	79	1	354	—	474
Net revenues . . . . .	<u>\$3,340</u>	<u>\$1,228</u>	<u>\$642</u>	<u>\$ 888</u>	<u>\$ (67)</u>	<u>\$6,031</u>
Income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net . . . . .	\$ 813	\$ 118	\$175	\$ 263	\$ 25	\$1,394
Losses from unconsolidated investees . . .	67	—	—	—	—	67
Provision for income taxes . . . . .	<u>171</u>	<u>48</u>	<u>68</u>	<u>99</u>	<u>10</u>	<u>396</u>
Income from continuing operations before cumulative effect of accounting change, net(2) . . . . .	<u>\$ 575</u>	<u>\$ 70</u>	<u>\$107</u>	<u>\$ 164</u>	<u>\$ 15</u>	<u>\$ 931</u>

**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

<u>Six Months Ended May 31, 2006</u>	<u>Institutional Securities(1)</u>	<u>Global Wealth Management Group</u>	<u>Asset Management</u>	<u>Discover</u>	<u>Intersegment Eliminations(1)</u>	<u>Total</u>
			<u>(dollars in millions)</u>			
Net revenues excluding net interest . . .	\$ 10,983	\$ 2,467	\$1,412	\$ 1,537	\$(166)	\$ 16,233
Net interest . . . . .	217	219	6	743	9	1,194
Net revenues . . . . .	<u>\$ 11,200</u>	<u>\$ 2,686</u>	<u>\$1,418</u>	<u>\$ 2,280</u>	<u>\$(157)</u>	<u>\$ 17,427</u>
Income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net . . . . .	\$ 4,021	\$ 180	\$ 396	\$ 1,020	\$ 6	\$ 5,623
Losses from unconsolidated investees . .	171	—	—	1	—	172
Provision for income taxes . . . . .	<u>1,309</u>	<u>60</u>	<u>156</u>	<u>381</u>	<u>2</u>	<u>1,908</u>
Income from continuing operations before cumulative effect of accounting change, net(2) . . . . .	<u>\$ 2,541</u>	<u>\$ 120</u>	<u>\$ 240</u>	<u>\$ 638</u>	<u>\$ 4</u>	<u>\$ 3,543</u>
<u>Six Months Ended May 31, 2005(3)</u>	<u>Institutional Securities</u>	<u>Global Wealth Management Group</u>	<u>Asset Management</u>	<u>Discover</u>	<u>Intersegment Eliminations</u>	<u>Total</u>
			<u>(dollars in millions)</u>			
Net revenues excluding net interest . . .	\$ 6,463	\$ 2,312	\$1,336	\$ 1,203	\$(137)	\$ 11,177
Net interest . . . . .	892	154	2	644	—	1,692
Net revenues . . . . .	<u>\$ 7,355</u>	<u>\$ 2,466</u>	<u>\$1,338</u>	<u>\$ 1,847</u>	<u>\$(137)</u>	<u>\$ 12,869</u>
Income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net . . . . .	\$ 1,890	\$ 471	\$ 462	\$ 617	\$ 49	\$ 3,489
Losses from unconsolidated investees . .	140	—	—	—	—	140
Provision for income taxes . . . . .	<u>455</u>	<u>187</u>	<u>175</u>	<u>233</u>	<u>19</u>	<u>1,069</u>
Income from continuing operations before cumulative effect of accounting change, net(2)(4) . . . . .	<u>\$ 1,295</u>	<u>\$ 284</u>	<u>\$ 287</u>	<u>\$ 384</u>	<u>\$ 30</u>	<u>\$ 2,280</u>
<u>Total Assets(5)</u>	<u>Institutional Securities</u>	<u>Global Wealth Management Group</u>	<u>Asset Management</u>	<u>Discover</u>	<u>Intersegment Eliminations</u>	<u>Total</u>
			<u>(dollars in millions)</u>			
At May 31, 2006 . . . . .	<u>\$977,016</u>	<u>\$19,706</u>	<u>\$3,588</u>	<u>\$26,846</u>	<u>\$(113)</u>	<u>\$1,027,043</u>
At November 30, 2005 . . . . .	<u>\$848,943</u>	<u>\$19,290</u>	<u>\$3,543</u>	<u>\$26,866</u>	<u>\$(119)</u>	<u>\$ 898,523</u>

(1) Net revenues for the quarter and six months ended May 31, 2006 included a \$30 million advisory fee related to the Company's sale of the aircraft leasing business that was eliminated in consolidation.

(2) See Note 15 for a discussion of discontinued operations.

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

(4) See Note 1 for a discussion of the cumulative effect of accounting change, net.

(5) Corporate assets have been fully allocated to the Company's business segments.



## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### 11. Variable Interest Entities.

Financial Accounting Standards Board (“FASB”) Interpretation No. 46, as revised (“FIN 46R”), “Consolidation of Variable Interest Entities,” applies to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties (“variable interest entities”). Variable interest entities (“VIE”) are required to be consolidated by their primary beneficiaries if they do not effectively disperse risks among parties involved. The primary beneficiary of a VIE is the party that absorbs a majority of the entity’s expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests. The Company is involved with various entities in the normal course of business that may be deemed to be VIEs and may hold interests therein, including debt securities, interest-only strip investments and derivative instruments that may be considered variable interests. Transactions associated with these entities include asset- and mortgage-backed securitizations and structured financings (including collateralized debt, bond or loan obligations and credit-linked notes). The Company engages in these transactions principally to facilitate client needs and as a means of selling financial assets. The Company consolidates entities in which it is deemed to be the primary beneficiary. For those entities deemed to be qualifying special purpose entities (as defined in SFAS No. 140), which includes the credit card asset securitization master trusts (see Note 4), the Company does not consolidate the entity.

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

At May 31, 2006, in connection with its Institutional Securities business, the aggregate size of VIEs, including financial asset-backed securitization, mortgage-backed securitization, collateralized debt obligation, credit-linked note, structured note, municipal bond trust, loan and bond issuing, commodities monetization, equity-linked note and exchangeable trust entities, for which the Company was the primary beneficiary of the entities was approximately \$20 billion, which is the carrying amount of the consolidated assets recorded as Financial instruments owned that are collateral for the entities’ obligations. The nature and purpose of these entities that the Company consolidated were to issue a series of notes to investors that provide the investors a return based on the holdings of the entities. These transactions were executed to facilitate client investment objectives. The structured note, equity-linked note, certain credit-linked note, certain mortgage-backed securitization, certain financial asset-backed securitization and municipal bond transactions also were executed as a means of selling financial assets. The Company holds either the entire class or a majority of the class of subordinated notes or entered into a derivative instrument with the VIE, which bears the majority of the expected losses or receives a majority of the expected residual returns of the entities. The Company consolidates these entities, in accordance with its consolidation accounting policy, and as a result eliminates all intercompany transactions, including derivatives and other intercompany transactions such as fees received to underwrite the notes or to structure the transactions. The Company accounts for the assets held by the entities as Financial instruments owned and the liabilities of the entities as Other secured financings. For those liabilities that include an embedded derivative, the Company has bifurcated such derivative in accordance with SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended. The beneficial interests of these consolidated entities are payable solely from the cash flows of the assets held by the VIE.

At May 31, 2006, also in connection with its Institutional Securities business, the aggregate size of the entities for which the Company holds significant variable interests, which consist of subordinated and other classes of beneficial interests, derivative instruments, limited partnership investments and secondary guarantees, was approximately \$34.9 billion. The Company’s variable interests associated with these entities, primarily credit-linked note, structured note, loan and bond issuing, collateralized debt and bond obligation, financial



## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

asset-backed securitization, mortgage-backed securitization and tax credit limited liability entities, including investments in affordable housing tax credit funds and underlying synthetic fuel production plants, were approximately \$19.3 billion consisting primarily of senior beneficial interests, which represent the Company's maximum exposure to loss at May 31, 2006. The Company may hedge the risks inherent in its variable interest holdings, thereby reducing its exposure to loss. The Company's maximum exposure to loss does not include the offsetting benefit of any financial instruments that the Company utilizes to hedge these risks.

#### 12. Guarantees.

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

**Derivative Contracts.** Certain derivative contracts meet the accounting definition of a guarantee, including certain written options, contingent forward contracts and credit default swaps. Although the Company's derivative arrangements do not specifically identify whether the derivative counterparty retains the underlying asset, liability or equity security, the Company has disclosed information regarding all derivative contracts that could meet the accounting definition of a guarantee. The maximum potential payout for certain derivative contracts, such as written interest rate caps and written foreign currency options, cannot be estimated as increases in interest or foreign exchange rates in the future could possibly be unlimited. Therefore, in order to provide information regarding the maximum potential amount of future payments that the Company could be required to make under certain derivative contracts, the notional amount of the contracts has been disclosed.

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

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

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

# MORGAN STANLEY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Liquidity Guarantees.** The Company has entered into liquidity facilities with special purpose entities and other counterparties, whereby the Company is required to make certain payments if losses or defaults occur. The Company often may have recourse to the underlying assets held by the special purpose entities in the event payments are required under such liquidity facilities.

The table below summarizes certain information regarding these guarantees at May 31, 2006:

Type of Guarantee	Maximum Potential Payout/Notional					Carrying Amount	Collateral/ Recourse
	Years to Maturity						
	Less than 1	1-3	3-5	Over 5	Total		
	(dollars in millions)						
Derivative contracts . . . . .	\$584,360	\$466,007	\$924,778	\$651,927	\$2,627,072	\$24,075	\$115
Standby letters of credit and other financial guarantees . . . . .	1,410	507	688	3,189	5,794	156	1,571
Market value guarantees . . . . .	16	171	32	645	864	50	121
Liquidity facilities . . . . .	963	496	49	100	1,608	—	—

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

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

**General Partner Guarantees.** As a general partner in certain private equity and real estate partnerships, the Company receives distributions from the partnerships according to the provisions of the partnership agreements. The Company may, from time to time, be required to return all or a portion of such distributions to the limited partners in the event the limited partners do not achieve a certain return as specified in various partnership agreements, subject to certain limitations. The maximum potential amount of future payments that the Company could be required to make under these provisions at May 31, 2006 and November 30, 2005 was \$304 million and \$349 million, respectively. As of May 31, 2006 and November 30, 2005, the Company's accrued liability for distributions that the Company has determined it is probable it will be required to refund based on the applicable refund criteria specified in the various partnership agreements was \$32 million and \$36 million, respectively.

**Securitized Asset Guarantees.** As part of the Company's Institutional Securities and Discover securitization activities, the Company provides representations and warranties that certain securitized assets conform to

# MORGAN STANLEY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

specified guidelines. The Company may be required to repurchase such assets or indemnify the purchaser against losses if the assets do not meet certain conforming guidelines. Due diligence is performed by the Company to ensure that asset guideline qualifications are met, and, to the extent the Company has acquired such assets to be securitized from other parties, the Company seeks to obtain its own representations and warranties regarding the assets. The maximum potential amount of future payments the Company could be required to make would be equal to the current outstanding balances of all assets subject to such securitization activities. Also, in connection with originations of residential mortgage loans under the Company's FlexSource® program, the Company may permit borrowers to pledge marketable securities as collateral instead of requiring cash down payments for the purchase of the underlying residential property. Upon sale of the residential mortgage loans, the Company may provide a surety bond that reimburses the purchasers for shortfalls in the borrowers' securities accounts up to certain limits if the collateral maintained in the securities accounts (along with the associated real estate collateral) is insufficient to cover losses that purchasers experience as a result of defaults by borrowers on the underlying residential mortgage loans. The Company requires the borrowers to meet daily collateral calls to ensure the marketable securities pledged in lieu of a cash down payment are sufficient. At May 31, 2006 and November 30, 2005, the maximum potential amount of future payments the Company may be required to make under its surety bond was \$137 million and \$157 million, respectively. The Company has not recorded any contingent liability in the condensed consolidated financial statements for these representations and warranties and reimbursement agreements and believes that the probability of any payments under these arrangements is remote.

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

The table below summarizes certain information regarding merchant chargeback guarantees during the quarters and six month periods ended May 31, 2006 and 2005:

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
Losses related to merchant chargebacks (dollars in millions) . . . . .	\$ 1.4	\$ 1.9	\$ 1.9	\$ 3.9
Aggregate credit card transaction volume (dollars in billions) . . . . .	24.8	21.2	48.0	42.0

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The amount of the liability related to the Company's credit cardmember merchant guarantee was not material at May 31, 2006. The Company mitigates this risk by withholding settlement from merchants or obtaining escrow deposits from certain merchants that are considered higher risk due to various factors such as time delays in the delivery of products or services. The table below provides information regarding the settlement withholdings and escrow deposits:

	At May 31, 2006	At November 30, 2005
	(dollars in millions)	
Settlement withholdings and escrow deposits . . . . .	\$49	\$42

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

#### 13. Investments in Unconsolidated Investees.

The Company invests in unconsolidated investees that own synthetic fuel production plants. The Company accounts for these investments under the equity method of accounting. The Company's share of the operating losses generated by these investments is recorded within Losses from unconsolidated investees, and the tax credits and the tax benefits associated with these operating losses are recorded within the Company's Provision for income taxes.

The table below provides information regarding the losses from unconsolidated investees, tax credits and tax benefits on the losses:

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
	(dollars in millions)			
Losses from unconsolidated investees . . . . .	\$103	\$67	\$172	\$140
Tax credits . . . . .	—	67	74	145
Tax benefits on losses . . . . .	40	27	67	56

Under the current tax law, synthetic fuels tax credits are granted under Section 45K of the Internal Revenue Code. Synthetic fuels tax credits are available in full only when the price of oil is less than a base price specified by the tax code, as adjusted for inflation ("Base Price"). The Base Price for each calendar year is determined by the Secretary of the Treasury by April 1 of the following year. If the annual average price of a barrel of oil in 2006 or future years exceeds the applicable Base Price, the synthetic fuels tax credits generated by the Company's synthetic fuel facilities will be phased out, on a ratable basis, over the phase-out range. Synthetic fuels tax credits realized in prior years are not affected by this limitation. Due to the high level of crude oil prices in fiscal 2006 and continued uncertainty regarding the value of tax credits associated with synthetic fuel investments, two of the Company's investees idled production at their synthetic fuel production facilities during

# MORGAN STANLEY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

May 2006. Additionally, based on fiscal year to date and futures prices at May 31, 2006, the Company estimates that there will be a partial phase-out of tax credits earned in fiscal 2006. The impact of this anticipated partial phase-out is included within Losses from unconsolidated investees and the Provision for income taxes for the quarter and six months ended May 31, 2006.

In fiscal 2006, the Company entered into derivative contracts designed to reduce its exposure to rising oil prices and the potential phase-out of the synthetic fuels tax credits for 2006. Changes in fair value relative to these derivative contracts are included within Principal transactions-trading revenues.

### 14. Employee Benefit Plans.

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

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
	(dollars in millions)			
Service cost, benefits earned during the period	\$ 35	\$ 33	\$ 70	\$ 66
Interest cost on projected benefit obligation	37	35	74	70
Expected return on plan assets	(34)	(32)	(68)	(64)
Net amortization and other	12	9	24	18
Net periodic benefit expense	<u>\$ 50</u>	<u>\$ 45</u>	<u>\$100</u>	<u>\$ 90</u>

### 15. Discontinued Operations.

On August 17, 2005, the Company announced that its Board of Directors had approved management's recommendation to sell the Company's non-core aircraft leasing business. In connection with this action, the aircraft leasing business was classified as "held for sale" and reported as discontinued operations in the Company's condensed consolidated financial statements.

On January 30, 2006, the Company announced that it had signed a definitive agreement under which it would sell its aircraft leasing business to Terra Firma, a European private equity group, for approximately \$2.5 billion in cash and the assumption of liabilities. The sale was completed on March 24, 2006. The results for discontinued operations in the quarter ended February 28, 2006 include a loss of \$125 million (\$75 million after-tax) related to the impact of the finalization of the sales proceeds and balance sheet adjustments related to the closing.

The quarter and six month period of fiscal 2006 reflected net income of \$8 million and a net loss of \$25 million on discontinued operations, respectively. The results for the second quarter of fiscal 2006 reflected the results of operations of the aircraft leasing business through the date of sale.

#### *Summarized financial information for the Company's discontinued operations:*

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
Pre-tax gain/(loss) on discontinued operations	\$14	\$(5)	\$(42)	\$2

# MORGAN STANLEY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following is a summary of the assets and liabilities of the Company's aircraft leasing business:

	At November 30, 2005
	(dollars in millions)
<b>Assets:</b>	
Aircraft under operating leases .....	\$3,145
Other assets .....	54
<b>Total assets</b> .....	<u>\$3,199</u>
<b>Liabilities:</b>	
Payable to affiliates .....	\$2,055
Other liabilities .....	690
<b>Total liabilities</b> .....	<u>\$2,745</u>

### 16. Business Acquisitions.

**Goldfish.** On February 17, 2006, the Company completed the acquisition of the Goldfish credit card business in the U.K. The Company believes that the acquisition of Goldfish will add economies of scale through better utilization of the existing U.K. infrastructure and strengthen its position in the U.K. credit card market. Since the acquisition date, the results of Goldfish have been included within the Discover business segment. The acquisition price was approximately \$1,676 million, which was paid in cash during February 2006. The Company recorded goodwill and other intangible assets of approximately \$355 million in connection with the acquisition. The acquisition price is still subject to finalization, and the allocation of the price is preliminary and is subject to further adjustment as the valuation of certain intangible assets is still in process.

The following table summarizes the fair values of the assets acquired and the liabilities assumed at the date of the acquisition.

	At February 17, 2006
	(dollars in millions)
Consumer loans .....	\$1,316
Goodwill .....	232
Amortizable intangible assets .....	123
Other assets .....	20
Total assets acquired .....	1,691
Total liabilities assumed .....	15
Net assets acquired .....	<u>\$1,676</u>

The \$123 million of acquired amortizable intangible assets includes customer relationships of \$54 million (15-year estimated useful life) and trademarks of \$69 million (25-year estimated useful life).



## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### 17. Income Tax Examinations.

The Company is under continuous examination by the Internal Revenue Service (the “IRS”) and other tax authorities in certain countries, such as Japan and the U.K., and states in which the Company has significant business operations, such as New York. The tax years under examination vary by jurisdiction; for example, the current IRS examination, which recently began, covers 1999-2004. The Company has filed an appeal with respect to unresolved issues relative to the IRS examination of years 1994-1998. The Company believes that the settlement of the IRS examination of years 1994-1998 will not have a material negative impact on the condensed consolidated statement of income of the Company. The Company regularly assesses the likelihood of additional assessments in each of the taxing jurisdictions resulting from these and subsequent years’ examinations. The Company has established tax reserves that the Company believes are adequate in relation to the potential for additional assessments. Once established, the Company adjusts tax reserves only when more information is available or when an event occurs necessitating a change to the reserves. The Company believes that the resolution of tax matters will not have a material effect on the condensed consolidated financial condition of the Company, although a resolution could have a material impact on the Company’s condensed consolidated statement of income for a particular future period and on the Company’s effective income tax rate for any period in which such resolution occurs.

#### 18. Insurance Settlement.

On September 11, 2001, the U.S. experienced terrorist attacks targeted against New York City and Washington, D.C. The attacks in New York resulted in the destruction of the World Trade Center complex, where approximately 3,700 of the Company’s employees were located, and the temporary closing of the debt and equity financial markets in the U.S. Through the implementation of its business recovery plans, the Company relocated its displaced employees to other facilities.

In the first quarter of fiscal 2005, the Company settled its claim with its insurance carriers related to the events of September 11, 2001. The Company recorded a pre-tax gain of \$251 million as the insurance recovery was in excess of previously recognized costs related to the terrorist attacks (primarily write-offs of leasehold improvements and destroyed technology and telecommunications equipment in the World Trade Center complex, employee relocation and certain other employee-related expenditures).

The pre-tax gain, which was recorded as a reduction to non-interest expenses, is included within the Global Wealth Management Group (\$198 million), Asset Management (\$43 million) and Institutional Securities (\$10 million) segments. The insurance settlement was allocated to the respective segments in accordance with the relative damages sustained by each segment.

#### 19. Lease Adjustment.

Prior to the first quarter of fiscal 2005, the Company did not record the effects of scheduled rent increases and rent-free periods for certain real estate leases on a straight-line basis. In addition, the Company had been accounting for certain tenant improvement allowances as reductions to the related leasehold improvements instead of recording funds received as deferred rent and amortizing them as reductions to lease expense over the lease term. In the first quarter of fiscal 2005, the Company changed its method of accounting for these rent escalation clauses, rent-free periods and tenant improvement allowances to properly reflect lease expense over the lease term on a straight-line basis. The impact of this correction resulted in the Company recording \$109 million of additional rent expense in the first quarter of fiscal 2005. The impact of this change was included within non-interest expenses and reduced income before taxes within the Institutional Securities (\$71 million), Global Wealth Management Group (\$29 million), Asset Management (\$5 million) and Discover (\$4 million) segments. The impact of this correction to the six month period of fiscal 2005 was not material to the pre-tax income of each of the segments or to the Company.

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### 20. New Accounting Developments.

In June 2005, the FASB ratified the consensus reached in Emerging Issues Task Force (“EITF”) Issue No. 04-5, “Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights.” Under the provisions of EITF Issue No. 04-5, a general partner in a limited partnership is presumed to control that limited partnership and therefore should include the limited partnership in its consolidated financial statements regardless of the amount or extent of the general partner’s interest unless a majority of the limited partners can vote to dissolve or liquidate the partnership or otherwise remove the general partner without having to show cause or the limited partners have substantive participating rights that can overcome the presumption of control by the general partner. EITF Issue No. 04-5 was effective immediately for all newly formed limited partnerships and existing limited partnerships for which the partnership agreements have been modified. For all other existing limited partnerships for which the partnership agreements have not been modified, the Company is required to adopt EITF Issue No. 04-5 on December 1, 2006 in a manner similar to a cumulative-effect-type adjustment or by retrospective application. The Company is currently assessing the impact on these existing limited partnerships of adopting the provisions of EITF Issue No. 04-5; however, because the Company generally expects to provide limited partners in these funds with rights to remove the Company as general partner or rights to terminate the partnership, the Company does not expect the impact of EITF Issue No. 04-5 to be material.

In February 2006, the FASB issued SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments,” which amends SFAS No. 133 and SFAS No. 140. SFAS No. 155 permits hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation to irrevocably be accounted for at fair value, with changes in fair value recognized in the statement of income. The fair value election may be applied on an instrument-by-instrument basis. SFAS No. 155 also eliminates a restriction on the passive derivative instruments that a qualifying special purpose entity may hold. SFAS No. 155 is effective for those financial instruments acquired or issued after December 1, 2006. At adoption, any difference between the total carrying amount of the individual components of the existing bifurcated hybrid financial instrument and the fair value of the combined hybrid financial instrument will be recognized as a cumulative-effect adjustment to beginning retained earnings. The Company is currently evaluating the potential impact of adopting SFAS No. 155.

In March 2006, the FASB issued SFAS No. 156, “Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140.” SFAS No. 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The standard permits an entity to subsequently measure each class of servicing assets or servicing liabilities at fair value and report changes in fair value in the statement of income in the period in which the changes occur. SFAS No. 156 is effective for the Company as of December 1, 2006. The Company is currently evaluating the potential impact of adopting SFAS No. 156.

In April 2006, the FASB issued FASB Staff Position No. FIN 46(R)-6, “Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)” (“FSP FIN 46(R)-6”). FSP FIN 46(R)-6 requires that the determination of the variability to be considered in applying FIN 46R be based on an analysis of the design of the entity. In evaluating whether an interest with a variable interest entity creates or absorbs variability, FSP FIN 46(R)-6 focuses on the role of a contract or arrangement in the design of an entity, regardless of its legal form or accounting classification. The Company will adopt the guidance in FSP FIN 46(R)-6 prospectively beginning September 1, 2006 to all entities that the Company first becomes involved with and to all entities previously required to be analyzed under FIN 46R when a reconsideration event has occurred under paragraph 7 of FIN 46R. The Company does not expect the adoption of FSP FIN 46(R)-6 to have a material impact on its condensed consolidated financial statements.



## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### 21. Subsequent Events.

**Office Building.** In June 2006, the Company purchased a significant interest in a joint venture that indirectly owns title to 522 Fifth Avenue, a 23-floor office building in New York City (the “Building”), for approximately \$420 million. Concurrently, the Company entered into an occupancy agreement with the joint venture pursuant to which the Company will occupy the office space in the Building (approximately 580,000 square feet).

**TransMontaigne Inc.** In June 2006, Morgan Stanley Capital Group Inc., a wholly-owned subsidiary of the Company, entered into a definitive Agreement and Plan of Merger to effect the acquisition of TransMontaigne Inc., a Denver-based company that operates pipelines, terminals and barges, and distributes and markets refined petroleum products. The Company will purchase the outstanding common shares of TransMontaigne Inc. for \$11.35 per share, or an aggregate cost of approximately \$610 million. The transaction is subject to customary closing conditions and is expected to be completed during the third or fourth quarter of fiscal 2006.

**Preferred Stock.** In July 2006, the Company issued \$1 billion of Floating Rate Non-Cumulative Preferred Stock, Series A.

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Morgan Stanley:

We have reviewed the accompanying condensed consolidated statement of financial condition of Morgan Stanley and subsidiaries (the "Company") as of May 31, 2006, and the related condensed consolidated statements of income and comprehensive income for the three-month and six-month periods ended May 31, 2006 and 2005, and condensed consolidated statements of cash flows for the six-month periods ended May 31, 2006 and 2005. These interim financial statements are the responsibility of the management of Morgan Stanley.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition of Morgan Stanley and subsidiaries as of November 30, 2005, and the related consolidated statements of income, comprehensive income, cash flows and changes in shareholders' equity for the fiscal year then ended (not presented herein) included in Morgan Stanley's Annual Report on Form 10-K for the fiscal year ended November 30, 2005; and in our report dated February 8, 2006, which report contains an explanatory paragraph relating to the adoption in 2005 of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" and the change in classification of repurchase transactions in the consolidated statements of cash flows, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated statement of financial condition as of November 30, 2005 is fairly stated, in all material respects, in relation to the consolidated statement of financial condition from which it has been derived.

As discussed in Note 1 to the condensed consolidated interim financial statements, effective December 1, 2005, Morgan Stanley changed its accounting policy for recognition of equity awards granted to retirement-eligible employees.

/s/ DELOITTE & TOUCHE LLP

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New York, New York  
July 6, 2006

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Introduction.

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

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

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

*Asset Management* provides global asset management products and services in equities, fixed income and alternative investment products through three principal distribution channels: a proprietary channel consisting of the Company's representatives; a non-proprietary channel consisting of third-party broker-dealers, banks, financial planners and other intermediaries; and the Company's institutional sales channel; and engages in investment activities.

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

The discussion of the Company's results of operations below (including "Business Outlook") may contain forward-looking statements. These statements, which reflect management's beliefs and expectations, are subject to risks and uncertainties that may cause actual results to differ materially. For a discussion of the risks and uncertainties that may affect the Company's future results, please see "Forward-Looking Statements" immediately preceding Part I, Item 1, "Competition" and "Regulation" in Part I, Item 1, "Risk Factors" in Part I, Item 1A, "Certain Factors Affecting Results of Operations" in Part II, Item 7 and other items throughout the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2005 (the "Form 10-K"), "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's 2006 Quarterly Reports on Form 10-Q and in other items throughout the Form 10-K, Forms 10-Q and the Company's 2006 Current Reports on Form 8-K.

The Company's results of operations for the quarters and six month periods ended May 31, 2006 and 2005 are discussed below. The results of the Company's aircraft leasing business are reported as discontinued operations for all periods presented (see "Discontinued Operations" herein).

## Results of Operations.

### Executive Summary.

### Financial Information.

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005(1)	2006	2005(1)
<b>Net revenues (dollars in millions):</b>				
Institutional Securities .....	\$5,726	\$3,340	\$11,200	\$ 7,355
Global Wealth Management Group .....	1,402	1,228	2,686	2,466
Asset Management .....	723	642	1,418	1,338
Discover .....	1,191	888	2,280	1,847
Intersegment Eliminations .....	(98)	(67)	(157)	(137)
Consolidated net revenues .....	<u>\$8,944</u>	<u>\$6,031</u>	<u>\$17,427</u>	<u>\$12,869</u>
<b>Income before taxes (dollars in millions)(2):</b>				
Institutional Securities .....	\$2,267	\$ 813	\$ 4,021	\$ 1,890
Global Wealth Management Group .....	157	118	180	471
Asset Management .....	224	175	396	462
Discover .....	541	263	1,020	617
Intersegment Eliminations .....	(13)	25	6	49
Consolidated income before taxes .....	<u>\$3,176</u>	<u>\$1,394</u>	<u>\$ 5,623</u>	<u>\$ 3,489</u>
<b>Consolidated net income (dollars in millions)</b> .....	<u>\$1,957</u>	<u>\$ 928</u>	<u>\$ 3,518</u>	<u>\$ 2,330</u>
<b>Earnings per basic share:</b>				
Income from continuing operations .....	\$ 1.92	\$ 0.88	\$ 3.48	\$ 2.15
Income (loss) on discontinued operations .....	0.01	—	(0.02)	—
Cumulative effect of accounting change, net .....	—	—	—	0.05
Earnings per basic share .....	<u>\$ 1.93</u>	<u>\$ 0.88</u>	<u>\$ 3.46</u>	<u>\$ 2.20</u>
<b>Earnings per diluted share:</b>				
Income from continuing operations .....	\$ 1.85	\$ 0.86	\$ 3.35	\$ 2.10
Income (loss) on discontinued operations .....	0.01	—	(0.02)	—
Cumulative effect of accounting change, net .....	—	—	—	0.05
Earnings per diluted share .....	<u>\$ 1.86</u>	<u>\$ 0.86</u>	<u>\$ 3.33</u>	<u>\$ 2.15</u>
<b>Statistical Data.</b>				
<b>Book value per common share(3)</b> .....	\$30.09	\$26.07	\$ 30.09	\$ 26.07
<b>Average common equity (dollars in billions)(4):</b>				
Institutional Securities .....	\$ 18.1	\$ 14.3	\$ 17.1	\$ 14.1
Global Wealth Management Group .....	3.3	3.6	3.4	3.7
Asset Management .....	2.1	1.7	2.0	1.7
Discover .....	5.0	4.2	4.8	4.3
Total from operating segments .....	28.5	23.8	27.3	23.8
Discontinued operations .....	—	1.5	—	1.5
Unallocated capital .....	2.7	3.1	3.1	3.1
Consolidated .....	<u>\$ 31.2</u>	<u>\$ 28.4</u>	<u>\$ 30.4</u>	<u>\$ 28.4</u>

*Statistical Data—(Continued).*

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005(1)	2006	2005(1)
<b>Return on average common equity(4):</b>				
Consolidated .....	25%	13%	23%	16%
Institutional Securities .....	30%	16%	30%	18%
Global Wealth Management Group .....	13%	8%	7%	15%
Asset Management .....	26%	25%	24%	33%
Discover .....	27%	16%	27%	18%
<b>Effective income tax rate .....</b>	<b>36.6%</b>	<b>29.8%</b>	<b>35.0%</b>	<b>32.1%</b>
<b>Worldwide employees .....</b>	<b>53,163</b>	<b>54,142</b>	<b>53,163</b>	<b>54,142</b>
<b>Consolidated assets under management or supervision (dollars in billions):</b>				
Equity .....	\$ 303	\$ 265	\$ 303	\$ 265
Fixed income .....	109	106	109	106
Money market .....	80	84	80	84
Alternative investments .....	20	18	20	18
Real estate .....	52	33	52	33
Total assets under management .....	564	506	564	506
Unit investment trusts .....	13	11	13	11
Other(5) .....	48	48	48	48
Total assets under management or supervision(6) ....	<u>\$ 625</u>	<u>\$ 565</u>	<u>\$ 625</u>	<u>\$ 565</u>
<b>Institutional Securities:</b>				
Mergers and acquisitions completed transactions (dollars in billions)(7):				
Global market volume .....	\$ 174.4	\$ 95.5	\$ 284.2	\$ 124.2
Market share .....	31.7%	25.4%	30.0%	20.5%
Rank .....	2	2	2	4
Mergers and acquisitions announced transactions (dollars in billions)(7):				
Global market volume .....	\$ 199.9	\$ 200.9	\$ 350.7	\$ 324.7
Market share .....	20.0%	34.0%	23.6%	33.3%
Rank .....	4	1	5	1
Global equity and equity-related issues (dollars in billions)(7):				
Global market volume .....	\$ 18.8	\$ 5.7	\$ 23.7	\$ 15.5
Market share .....	9.7%	6.3%	8.7%	9.4%
Rank .....	2	6	3	4
Global debt issues (dollars in billions)(7):				
Global market volume .....	\$ 99.0	\$ 84.1	\$ 173.0	\$ 154.3
Market share .....	6.2%	5.8%	6.4%	6.1%
Rank .....	5	5	5	4
Global initial public offerings (dollars in billions)(7):				
Global market volume .....	\$ 7.5	\$ 2.1	\$ 8.9	\$ 4.8
Market share .....	11.7%	8.6%	10.3%	10.9%
Rank .....	2	2	2	1
Pre-tax profit margin(8) .....	40%	24%	36%	26%

*Statistical Data—(Continued).*

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005(1)	2006	2005(1)
<b>Global Wealth Management Group:</b>				
Global representatives . . . . .	8,179	10,438	8,179	10,438
Annualized net revenue per global representative (dollars in thousands)(9) . . . . .	\$ 653	\$ 470	\$ 607	\$ 461
Client assets by segment (dollars in billions)				
\$10 million or more . . . . .	\$ 172	\$ 148	\$ 172	\$ 148
\$1 million – \$10 million . . . . .	225	211	225	211
\$100,000 – \$1 million . . . . .	183	190	183	190
Less than \$100,000 . . . . .	29	36	29	36
Client assets excluding corporate and other accounts . . . . .	609	585	609	585
Corporate and other accounts . . . . .	30	28	30	28
Total client assets . . . . .	<u>\$ 639</u>	<u>\$ 613</u>	<u>\$ 639</u>	<u>\$ 613</u>
Fee-based assets as a percentage of total client assets . . . . .	30%	27%	30%	27%
Bank deposit program (dollars in millions)(10) . . . . .	\$ 9,114	\$ 446	\$ 9,114	\$ 446
Pre-tax profit margin(8) . . . . .	11%	10%	7%	19%
<b>Asset Management:</b>				
Assets under management or supervision (dollars in billions) . . . . .	\$ 440	\$ 416	\$ 440	\$ 416
Percent of fund assets in top half of Lipper rankings(11) . . . . .	48%	76%	48%	76%
Pre-tax profit margin(8) . . . . .	31%	27%	28%	35%
Pre-tax profit margin(8) (excluding private equity) . . . . .	25%	29%	25%	34%
<b>Discover (dollars in millions, unless otherwise noted)(12):</b>				
Period-end credit card loans—Owned . . . . .	\$21,764	\$19,385	\$21,764	\$19,385
Period-end credit card loans—Managed . . . . .	\$48,539	\$46,845	\$48,539	\$46,845
Average credit card loans—Owned . . . . .	\$19,664	\$18,753	\$20,808	\$18,979
Average credit card loans—Managed . . . . .	\$47,307	\$47,146	\$47,439	\$48,028
Net principal charge-off rate—Owned . . . . .	3.02%	4.62%	3.82%	4.62%
Net principal charge-off rate—Managed . . . . .	3.30%	4.94%	4.18%	5.03%
Return on average receivables—Owned . . . . .	6.83%	3.48%	6.15%	4.06%
Return on average receivables—Managed . . . . .	2.84%	1.38%	2.70%	1.60%
Transaction volume (dollars in billions):				
Net sales . . . . .	\$ 24.0	\$ 21.1	\$ 46.5	41.9
Other transaction volume . . . . .	4.5	4.3	8.9	9.4
Total . . . . .	<u>\$ 28.5</u>	<u>\$ 25.4</u>	<u>\$ 55.4</u>	<u>\$ 51.3</u>
Payment services transaction volume (in millions):				
Discover network . . . . .	340	315	679	629
PULSE network . . . . .	471	457	896	673
Total network transaction volume . . . . .	<u>811</u>	<u>772</u>	<u>1,575</u>	<u>1,302</u>
Pre-tax profit margin(8) . . . . .	45%	30%	45%	33%

- (1) Certain prior-period information has been reclassified to conform to the current period's presentation.
- (2) Amounts represent income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net.
- (3) Book value per common share equals shareholders' equity of \$32,255 million at May 31, 2006 and \$28,330 million at May 31, 2005, divided by common shares outstanding of 1,072 million at May 31, 2006 and 1,087 million at May 31, 2005, respectively.
- (4) The Company uses an economic capital model to determine the amount of equity capital needed to support the risk of its business activities and to ensure that the Company remains adequately capitalized. Economic capital is defined as the amount of capital needed to run the business through the business cycle and satisfy the requirements of regulators, rating agencies and the market. The Company's methodology is based on an approach that assigns economic capital to each segment based on regulatory capital usage plus additional capital for stress losses, goodwill and principal investment risk. The economic capital model and allocation methodology may be enhanced over time in response to changes in the business and regulatory environment. The effective tax rates used in the computation of segment return on average common equity were determined on a separate entity basis.
- (5) Amounts include assets under management or supervision associated with the Global Wealth Management Group business.
- (6) Revenues and expenses associated with these assets are included in the Company's Asset Management, Global Wealth Management Group and Institutional Securities segments.
- (7) Source: Thomson Financial, data as of June 7, 2006—The data for the three months ended May 31, 2006 and 2005 are for the periods from March 1 to May 31, 2006 and March 1 to May 31, 2005, respectively. The data for the six months ended May 31 are for the periods from January 1 to May 31, 2006 and January 1 to May 31, 2005, respectively, as Thomson Financial presents these data on a calendar-year basis.
- (8) 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.
- (9) Amounts equal to Global Wealth Management Group's net revenues divided by average global representative headcount for the periods represented.
- (10) Bank deposits are held at certain of the Company's Federal Deposit Insurance Corporation insured depository institutions for the benefit of retail clients through their brokerage accounts.
- (11) Source: Lipper, one-year performance excluding money market funds as of May 31, 2006 and 2005, respectively.
- (12) Managed data include owned and securitized credit card loans. For an explanation of managed data and a reconciliation of credit card loan and asset quality data, see "Discover—Managed General Purpose Credit Card Loan Data" herein.

## ***Second Quarter 2006 Performance.***

***Company Results.*** The Company recorded net income of \$1,957 million for the quarter ended May 31, 2006, an increase of 111% from the comparable fiscal 2005 period. Net revenues (total revenues less interest expense and the provision for loan losses) increased 48% to a record \$8,944 million. Non-interest expenses of \$5,768 million increased 24% from the prior year period, primarily due to higher compensation costs. Diluted earnings per share were \$1.86 compared with \$0.86 in the second quarter of fiscal 2005. The annualized return on average common equity was 25.1% compared with 13.1% in the second quarter of last year.

For the six month period ended May 31, 2006, net income was \$3,518 million, a 51% increase from \$2,330 million a year ago. Net revenues rose 35% to \$17,427 million and non-interest expenses increased 26% to \$11,804 million. Diluted earnings per share were \$3.33 compared with \$2.15 a year ago. The annualized return on average common equity for the six month period was 23.1% compared with 16.4% in the prior year period.

The pre-tax results for the six month period ended May 31, 2005 included a \$360 million charge related to the Coleman litigation matter, a \$109 million charge for the correction in the method of accounting for certain real estate leases, and a gain of \$251 million related to an insurance settlement (see "Other Items" herein). The pre-tax results for the quarter and six month period ended May 31, 2005 also included legal accruals of approximately \$120 million related to the Parmalat matter.

The Company's effective income tax rate was 36.6% and 35.0% for the quarter and six month period ended May 31, 2006 compared with 29.8% and 32.1 % in the quarter and six month period ended May 31, 2005. The increase in both periods primarily reflected lower estimated domestic tax credits and higher earnings, which reduced the effect of permanent differences. The decrease in domestic tax credits was primarily due to the anticipated partial phase-out of the benefits of synthetic fuel tax credits as a result of the high level of crude oil prices.

***Institutional Securities.*** Institutional Securities recorded income from continuing operations of \$2,267 million before losses from unconsolidated investees, income taxes and net cumulative effect of accounting change, a 179% increase from last year's second quarter. Net revenues rose 71% to a record \$5,726 million. The increases



were driven by near-record fixed income and equity sales and trading revenues, along with higher investment banking revenues. Non-interest expenses increased 37% to \$3,459 million, reflecting higher compensation accruals primarily resulting from higher net revenues.

Investment banking advisory revenues increased 8% from last year's second quarter to \$385 million. Underwriting revenues rose 77% from last year's second quarter to \$670 million.

Fixed income sales and trading revenues were a near-record \$2,366 million, up 95% from the second quarter of fiscal 2005. The increase was driven by record results in credit products and the second best quarter ever in commodities. Credit products benefited from significantly improved performance in corporate credit trading following a weak second quarter of fiscal 2005 and continuing strong results in residential and commercial securitized products. The increase in commodities revenues primarily reflected strong revenues from electricity and natural gas products. These and related businesses continued to benefit from high market volatility and activity levels. Interest rate and currency product revenues were up slightly, benefiting from strong client flows and higher foreign exchange trading revenues. Equity sales and trading revenues were \$1,724 million, an increase of 54% as compared with the prior year quarter and were the second best quarter on record. The increase was driven by higher revenues from derivatives and equity cash products, a strong performance in principal trading strategies and record results in the prime brokerage business.

Principal transaction net investment revenues increased 163% to \$595 million in the quarter from the corresponding period in the prior year. The increase primarily reflected net gains from investments in the Company's real estate funds, Grifols S.A., Wacker Chemie AG and the NYSE Group, Inc.

*Global Wealth Management Group.* Global Wealth Management Group recorded income of \$157 million before taxes and net cumulative effect of accounting change, an increase of 33% from the second quarter of fiscal 2005. Net revenues increased 14% from last year's second quarter to \$1,402 million, driven by higher net interest revenues primarily resulting from the bank deposit program, and higher revenues from commissions and asset management, distribution and administration fees. The increase in net revenues also reflected higher investment banking and principal transaction investment revenues. Total non-interest expenses increased 12% from a year ago to \$1,245 million, reflecting increased compensation due, in part, to higher revenues as well as severance-related costs. Total client assets increased to \$639 billion, up 4% from last year's second quarter. Client assets in fee-based accounts rose 15% to \$190 billion at May 31, 2006 and increased to a record 30% of total client assets from 27% a year ago. At quarter-end, the number of global representatives was 8,179, a decline of 2,259 from a year ago, resulting largely from planned sales force reductions completed during the first half of fiscal 2006 and during the latter half of fiscal 2005 and attrition.

*Asset Management.* Asset Management recorded income of \$224 million before taxes and net cumulative effect of accounting change, a 28% increase from last year's second quarter. Net revenues of \$723 million increased 13% from a year ago, largely due to higher private equity revenues. Non-interest expenses increased 7% to \$499 million, primarily due to higher compensation and benefits expense associated with a higher level of net revenues, partially offset by lower non-compensation expenses. Assets under management or supervision within Asset Management of \$440 billion were up \$24 billion, or 6%, from the second quarter of last year, primarily due to market appreciation, partially offset by customer net outflows.

*Discover.* Discover had record income of \$541 million before losses from unconsolidated investees, income taxes and net cumulative effect of accounting change, an increase of 106% from the second quarter of fiscal 2005. Record net revenues of \$1,191 million were 34% higher than a year ago, primarily due to higher servicing and securitization income and a lower provision for consumer loan losses. Servicing and securitization income of \$651 million increased 54% from a year ago due primarily to lower charge-offs associated with the securitized portfolio. The provision for consumer loan losses of \$130 million declined 38% from last year reflecting lower net charge-offs, benefiting from continued improvement in underlying credit quality and lower bankruptcy filings following federal bankruptcy legislation that became effective in October 2005. Non-interest expenses of \$650 million increased 4% from a year ago, primarily due to higher compensation and operating expenses associated with the acquisition of the



Goldfish credit card business in the U.K. on February 17, 2006 (see “Business Acquisitions” herein). The managed credit card net principal charge-off rate decreased 164 basis points to 3.30% from the same period a year ago. The managed over-30-day delinquency rate decreased 61 basis points to 3.29% from a year ago, and the managed over-90-day delinquency rate was 30 basis points lower than a year ago at 1.53%. Managed credit card loans were \$48,539 million at quarter-end, a 4% increase from a year ago, reflecting strong transaction volume and the Goldfish acquisition, partially offset by higher payment rates. Payment rates on managed credit card loans reached over 20% driven by improved credit quality and industry-wide trends.

### ***Business Outlook.***

Entering the third quarter of fiscal 2006, investment banking activity remained strong, although conditions in the global financial markets were weaker as compared with conditions that existed for the majority of the first half of fiscal 2006. Such conditions, along with the lower level of business activity in Institutional Securities and Global Wealth Management that typically occurs during the summer months, could affect the Company’s results for the second half of fiscal 2006. In addition, although consumer bankruptcy filings remain well below historical levels, the Company expects charge-offs in the Discover segment to rise from the low second quarter levels, but remain below 5% on a managed basis, as pressures on consumers continue and bankruptcies begin to return to more normalized levels in the second half of fiscal 2006. In addition, Discover’s marketing expenses are expected to increase in the second half of fiscal 2006 as compared with the six months ended May 31, 2006 in conjunction with new initiatives and typical seasonal trends. Discover remains focused on building broader acceptance of the Discover Network in the U.S., with a goal of achieving parity with the other bankcard networks by 2008.

### **Global Market and Economic Conditions in the Quarter and Six Month Period Ended May 31, 2006.**

The U.S. economy remained generally strong during the six month period ended May 31, 2006, supported by consumer spending, business investment and productivity gains, partially offset by a softer residential real estate market. U.S. consumer bankruptcy filings remained relatively low following the bankruptcy legislation that became effective in October 2005. The U.S. unemployment rate declined to 4.6% at the end of the quarter. Conditions in the equity markets were generally favorable during the majority of the second quarter, but increasing concerns over oil prices, inflation and the Federal Reserve Board’s (the “Fed”) continued monetary policy actions resulted in a sell-off during the last month of the period. The Fed raised both the overnight lending rate and the discount rate on two separate occasions in the second quarter by an aggregate of 0.50% and on four separate occasions in the six month period by an aggregate of 1.00%. Subsequent to May 31, 2006, the Fed raised both the overnight lending rate and the discount rate by an additional 0.25%.

In Europe, economic growth was supported by exports, business investment and a recovery in Germany, while consumer spending declined. The European Central Bank (the “ECB”) raised the benchmark interest rate by 0.25% in the quarter and 0.50% in the six month period. Subsequent to May 31, 2006, the ECB raised the benchmark interest rate by an additional 0.25%. In the U.K., economic growth was modest and was supported by higher business investment, partially offset by a decline in consumer spending. During the quarter, the Bank of England left the benchmark interest rate unchanged.

The Japanese economy continued to recover steadily as business investment, corporate profitability and exports improved. The jobless rate continued to be near a seven-year low, which had a favorable impact on consumer confidence. The Japanese equity markets declined modestly in the quarter primarily due to concerns over higher global interest rates. Economic growth elsewhere in Asia continued, including in China, driven by strength in domestic spending and exports.

### **Business Segments.**

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

As a result of treating certain intersegment transactions as transactions with external parties, the Company includes an Intersegment Eliminations category to reconcile the segment results to the Company's consolidated results. Income before taxes in Intersegment Eliminations primarily 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. (Loss) income before taxes recorded in Intersegment Eliminations was \$(13) million and \$25 million in the quarters ended May 31, 2006 and 2005, respectively, and \$6 million and \$49 million in the six month periods ended May 31, 2006 and 2005, respectively. The results for the fiscal 2006 periods also included a \$30 million advisory fee related to the Company's sale of the aircraft leasing business that was eliminated in consolidation.

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

**INSTITUTIONAL SECURITIES**  
**INCOME STATEMENT INFORMATION**

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
	(dollars in millions)			
Revenues:				
Investment banking .....	\$ 1,055	\$ 735	\$ 1,958	\$ 1,477
Principal transactions:				
Trading .....	3,617	1,684	6,562	3,411
Investments .....	595	226	879	317
Commissions .....	694	538	1,304	1,041
Asset management, distribution and administration fees .....	73	39	117	73
Interest and dividends .....	9,318	5,379	19,109	10,654
Other .....	85	78	163	144
Total revenues .....	15,437	8,679	30,092	17,117
Interest expense .....	9,711	5,339	18,892	9,762
Net revenues .....	5,726	3,340	11,200	7,355
Total non-interest expenses .....	3,459	2,527	7,179	5,465
Income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net .....	2,267	813	4,021	1,890
Losses from unconsolidated investees .....	103	67	171	140
Provision for income taxes .....	786	171	1,309	455
Income from continuing operations before cumulative effect of accounting change, net .....	\$ 1,378	\$ 575	\$ 2,541	\$ 1,295

**Investment Banking.** Investment banking revenues for the quarter increased 44% from the comparable period of fiscal 2005. The increase was due to higher revenues from equity and fixed income underwriting transactions and merger, acquisition and restructuring activities. Underwriting revenues were \$670 million, an increase of 77% from the comparable period of fiscal 2005. Equity underwriting revenues increased 156% to \$371 million, reflecting an increase in industry-wide activity and were the highest quarterly revenues since the first quarter of fiscal 2000. Fixed income underwriting revenues increased 28% to \$299 million, reflecting higher revenues from investment grade and non-investment grade fixed income products. Advisory fees from merger, acquisition and restructuring transactions were \$385 million, an increase of 8% from the comparable period of fiscal 2005. The increase in advisory fees reflected an increase in completed transactions. Advisory fees in the current quarter also included a \$30 million fee related to the Company's sale of the aircraft leasing business that was eliminated in consolidation.

At May 31, 2006, the backlog of merger, acquisition and restructuring transactions and equity underwriting transactions was higher as compared with the end of the second quarter of fiscal 2005. The backlog of both merger, acquisition and restructuring transactions and equity underwriting transactions is subject to the risk that transactions may not be completed due to unforeseen economic and market conditions, adverse developments regarding one of the parties to the transaction, a failure to obtain required regulatory approval or a decision on the part of the parties involved not to pursue a transaction.

Investment banking revenues in the six month period ended May 31, 2006 increased 33% from the comparable period of fiscal 2005. The increase was due to higher revenues from both equity and fixed income underwriting transactions and merger, acquisition and restructuring activities.

**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.

Total sales and trading revenues increased 73% in the quarter ended May 31, 2006 from the comparable period of fiscal 2005, reflecting near-record fixed income and equity sales and trading revenues.

Sales and trading revenues include the following:

	<b>Three Months Ended May 31,</b>		<b>Six Months Ended May 31,</b>	
	<b>2006</b>	<b>2005(1)</b>	<b>2006</b>	<b>2005(1)</b>
	<b>(dollars in millions)</b>			
Equity .....	\$1,724	\$1,119	\$3,378	\$2,333
Fixed income(2) .....	2,366	1,211	5,090	3,209

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

(2) Amounts include interest rate and currency products, credit products and commodities. Amounts exclude revenues from corporate lending activities.

Equity sales and trading revenues increased 54% as compared with the prior year quarter and were the second best quarter on record. The increase was driven by higher revenues from derivatives and equity cash products, a strong performance in principal trading strategies and record results in the prime brokerage business. Increased client flows across both the derivatives and cash equity markets drove revenues higher, particularly in Europe and Asia. Favorable trading opportunities positively impacted the quarter's results as major global equity market indices trended higher in the beginning of the quarter. The increase in prime brokerage revenues reflected record levels of customer balances. Although commission revenues increased, revenues continued to be adversely affected by intense competition particularly in the U.S. and a continued shift toward electronic trading.

Fixed income sales and trading revenues increased 95% as compared with the prior year quarter and were the second best quarter on record. The increase reflected record results in credit products and the second best quarter ever in commodities. Credit product revenues increased 161% primarily due to record revenues from corporate credit products, which benefited from significantly improved performance in corporate credit trading following a weak second quarter of fiscal 2005 and continuing strong results in residential and commercial securitized products. Commodities revenues increased 268% and were the second best quarter on record. The increase was primarily due to strong revenues from electricity and natural gas products. Energy prices were volatile during the quarter driven by geopolitical issues and weather conditions in the U.S. Interest rate and currency product revenues increased 4% primarily due to strong client flows and higher foreign exchange trading revenue.

Total sales and trading revenues increased 51% in the six month period ended May 31, 2006 from the comparable period of fiscal 2005, reflecting higher revenues from equity and fixed income products. Equity sales and trading revenues increased 45%, driven primarily by higher revenues in derivative products, principal trading strategies, equity cash products and the prime brokerage business. Increased client flows across both the derivatives and equity cash markets and favorable trading opportunities drove revenues higher. Revenues in the prime brokerage business reflected record levels of customer balances and new customer activity. Fixed income sales and trading revenues increased 59% primarily due to higher revenues in commodities and credit products. Commodities revenues increased primarily due to higher revenues from electricity and natural gas products and from oil liquids. Credit product revenues increased primarily due to strong revenues in corporate credit products

and strong demand in securitized products. Interest rate and currency product revenues decreased modestly, primarily due to lower revenues from interest rate derivatives, partially offset by higher revenues from foreign exchange products.

The increase in sales and trading results for the quarter reflected generally favorable overall market conditions as well as improved risk efficiency in comparison to the quarter ended May 31, 2005. For a further discussion of the Company's risk management policies, see "Quantitative and Qualitative Disclosures about Market Risk—Risk Management" in Part II, Item 7A of the Form 10-K.

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 the quarter ended May 31, 2006, revenues from corporate lending activities increased by approximately \$17 million, reflecting the impact of mark-to-market valuations associated with new loans made in the second quarter of fiscal 2006. In the six month period ended May 31, 2006, revenues from corporate lending activities were relatively unchanged from the comparable period of fiscal 2005.

**Principal Transactions-Investments.** Principal transaction net investment revenues increased 163% and 177% in the quarter and six month period ended May 31, 2006, respectively. The increase in both periods was primarily related to net gains associated with the Company's investments, including both realized and unrealized gains from investments in the Company's real estate funds, Grifols S.A., Wacker Chemie AG and the NYSE Group, Inc. The increase in the six month period also reflected a \$137 million net gain from the Company's position in IntercontinentalExchange.

**Asset Management, Distribution and Administration Fees.** Asset management, distribution and administration fees increased 87% in the quarter and 60% in the six month period ended May 31, 2006 from the comparable periods of fiscal 2005. The increase in both periods was primarily related to higher fees associated with real estate fund investments.

**Other.** Other revenues increased 9% and 13% in the quarter and six month period ended May 31, 2006, respectively, primarily driven by higher sales of benchmark indices and risk management analytic products.

**Non-Interest Expenses.** Non-interest expenses increased 37% and 31% in the quarter and the six month period ended May 31, 2006, respectively. Compensation and benefits expense increased 58% and 61% in the quarter and six month period, respectively, primarily reflecting higher incentive-based compensation accruals resulting from higher net revenues. The six month period also included Institutional Securities' share (\$270 million) of incremental compensation expense related to equity awards to retirement-eligible employees (see "Stock-Based Compensation" herein). Excluding compensation and benefits expense, non-interest expenses increased 4% in the quarter and decreased 13% in the six month period. Occupancy and equipment expense decreased 22% in the six month period 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 estate leases (see "Lease Adjustment" herein). Brokerage, clearing and exchange fees increased 31% and 27% in the quarter and six month period, respectively, primarily reflecting increased fixed income and equity trading activity. Professional services expense increased 31% and 21% in the quarter and six month period, respectively, primarily due to higher legal and consulting costs, reflecting increased levels of business activity. Other expense decreased 48% and 65% in the quarter and six month period, respectively, reflecting lower charges for legal and regulatory matters. Other expense in the second quarter of fiscal 2005 included legal accruals of approximately \$120 million related to the Parmalat matter and the six month period of fiscal 2005 included a \$360 million charge related to the Coleman litigation (see "Legal Proceedings" in Part I, Item 3 of the Form 10-K and in Part II, Item 1 herein).

**GLOBAL WEALTH MANAGEMENT GROUP**  
**INCOME STATEMENT INFORMATION**

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
	(dollars in millions)			
Revenues:				
Investment banking .....	\$ 95	\$ 68	\$ 162	\$ 139
Principal transactions:				
Trading .....	121	111	245	231
Investments .....	26	(2)	26	(4)
Commissions .....	312	295	631	624
Asset management, distribution and administration fees .....	674	632	1,323	1,239
Interest and dividends .....	246	149	452	284
Other .....	44	45	80	83
Total revenues .....	1,518	1,298	2,919	2,596
Interest expense .....	116	70	233	130
Net revenues .....	1,402	1,228	2,686	2,466
Total non-interest expenses .....	1,245	1,110	2,506	1,995
Income before taxes and cumulative effect of accounting change, net .....	157	118	180	471
Provision for income taxes .....	51	48	60	187
Income before cumulative effect of accounting change, net .....	<u>\$ 106</u>	<u>\$ 70</u>	<u>\$ 120</u>	<u>\$ 284</u>

**Investment Banking.** Investment banking revenues increased 40% and 17% in the quarter and six month period ended May 31, 2006, primarily due to higher revenues from equity underwritings, including revenues from a fund private placement, and higher revenues from unit investment trust sales. The increase in investment banking revenues in the six month period was partially offset by lower revenues from fixed income underwritings.

**Principal Transactions—Trading.** Principal transaction trading revenues increased 9% and 6% in the quarter and six month period ended May 31, 2006, primarily due to higher revenues from government and municipal fixed income securities as well as foreign exchange securities.

**Principal Transactions—Investments.** Principal transaction investment net revenues were \$26 million in the quarter and six month period ended May 31, 2006 compared with net losses of \$(2) million and \$(4) million in the quarter and six month period ended May 31, 2005. The results in fiscal 2006 primarily reflected both realized and unrealized gains from the Company's investment in NYSE Group, Inc.

**Commissions.** Commission revenues increased 6% and 1% in the quarter and six month period ended May 31, 2006 from higher equity product revenues, primarily in international markets, in the second quarter of fiscal 2006.

**Net Interest.** Net interest revenues increased 65% and 42% in the quarter and six month period ended May 31, 2006, primarily due to increased account balances in the bank deposit program.

**Asset Management, Distribution and Administration Fees.** Asset management, distribution and administration fees increased 7% in the quarter and six month period ended May 31, 2006, primarily reflecting higher client assets in fee-based accounts.

Client asset balances increased to \$639 billion at May 31, 2006 from \$613 billion at May 31, 2005, primarily due to market appreciation. Client assets in fee-based accounts rose 15% to \$190 billion at May 31, 2006 and increased to a record 30% of total client assets from 27% in the prior-year period.

***Non-Interest Expenses.*** Non-interest expenses increased 12% and 26% in the quarter and six month period ended May 31, 2006, primarily reflecting an increase in compensation and benefits expense. The increase in the six month period was also due to a reduction in non-interest expenses in the prior year period related to Global Wealth Management Group's share (\$198 million) of the insurance settlement related to the events of September 11, 2001 (see "Insurance Settlement" herein). Compensation and benefits expense increased 17% in both the quarter and six month period ended May 31, 2006, primarily reflecting higher incentive-based compensation costs due to higher net revenues. Compensation and benefits expense for the quarter also included severance-related costs due to the sales force reduction conducted during the period. The six month period ended May 31, 2006 included Global Wealth Management Group's share (\$80 million) of the incremental compensation expense related to equity awards to retirement-eligible employees, including new hires (see "Stock-Based Compensation" herein). Excluding compensation and benefits expense and the insurance settlement, non-interest expenses increased 5% and 9% in the quarter and six month period. Occupancy and equipment expense decreased 14% in the six month period 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 "Lease Adjustment" herein). Professional services expense increased 25% and 30% in the quarter and six month period, largely due to higher legal fees, as well as higher sub-advisory fees associated with growth in fee-based assets. Other expenses increased 27% in the six month period, primarily resulting from higher costs associated with legal and regulatory matters. During the six month period ended May 31, 2006, the Company recorded legal and regulatory expenses of approximately \$80 million related to ongoing regulatory, employment and branch litigation matters.



**ASSET MANAGEMENT**  
**INCOME STATEMENT INFORMATION**

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
	(dollars in millions)			
Revenues:				
Investment banking	\$ 15	\$ 11	\$ 27	\$ 22
Principal transactions:				
Investments	69	2	99	66
Commissions	7	7	14	14
Asset management, distribution and administration fees	621	615	1,260	1,220
Interest and dividends	10	3	15	6
Other	6	6	12	14
Total revenues	728	644	1,427	1,342
Interest expense	5	2	9	4
Net revenues	723	642	1,418	1,338
Total non-interest expenses	499	467	1,022	876
Income before taxes and cumulative effect of accounting change, net	224	175	396	462
Provision for income taxes	89	68	156	175
Income before cumulative effect of accounting change, net	<u>\$135</u>	<u>\$107</u>	<u>\$ 240</u>	<u>\$ 287</u>

**Investment Banking.** Investment banking revenues increased 36% and 23% in the quarter and six month period ended May 31, 2006 primarily reflecting a higher volume of unit investment trust sales.

**Principal Transactions-Investments.** Principal transaction net investment gains aggregating \$69 million and \$99 million were recognized in the quarter and six month period ended May 31, 2006 as compared with net gains of \$2 million and \$66 million in the quarter and six month period ended May 31, 2005. The increase in both periods was primarily related to higher net gains on certain investments in the Company's private equity portfolio, including Aventine Renewable Energy Holdings, LLC. The results for the six month period ended May 31, 2005 included a gain on Triana Energy Holdings, LLC. Asset Management continues to wind down its legacy private equity business.



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

	At May 31, 2006	At May 31, 2005(1)	Average For the Three Months Ended		Average For the Six Months Ended	
			May 31, 2006	May 31, 2005(1)	May 31, 2006	May 31, 2005(1)
	(dollars in billions)					
Assets under management or supervision by distribution channel:						
Retail . . . . .	\$190	\$199	\$191	\$201	\$195	\$202
Institutional . . . . .	<u>250</u>	<u>217</u>	<u>254</u>	<u>219</u>	<u>248</u>	<u>222</u>
Total assets under management or supervision . . . . .	<u>\$440</u>	<u>\$416</u>	<u>\$445</u>	<u>\$420</u>	<u>\$443</u>	<u>\$424</u>
Assets under management or supervision by asset class:						
Equity . . . . .	\$226	\$205	\$232	\$203	\$229	\$203
Fixed income . . . . .	91	92	90	95	91	99
Money market . . . . .	75	80	76	82	77	82
Alternative investments . . . . .	20	18	19	19	19	19
Real estate . . . . .	<u>15</u>	<u>10</u>	<u>15</u>	<u>10</u>	<u>14</u>	<u>10</u>
Total assets under management . . . . .	427	405	432	409	430	413
Unit investment trusts . . . . .	<u>13</u>	<u>11</u>	<u>13</u>	<u>11</u>	<u>13</u>	<u>11</u>
Total assets under management or supervision . . . . .	<u>\$440</u>	<u>\$416</u>	<u>\$445</u>	<u>\$420</u>	<u>\$443</u>	<u>\$424</u>

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

Activity in Asset Management's customer assets under management or supervision were as follows (dollars in billions):

	Three Months Ended		Six Months Ended	
	May 31, 2006	May 31, 2005	May 31, 2006	May 31, 2005
(dollars in billions)				
<b>Balance at beginning of period</b> .....	\$442	\$427	\$431	\$424
Net flows excluding money markets .....	(1)	(4)	(6)	(12)
Net flows from money markets .....	(4)	(3)	(6)	(2)
Net market appreciation/(depreciation) .....	3	(4)	21	6
Total net (decrease)/increase .....	(2)	(11)	9	(8)
<b>Balance at end of period</b> .....	<u>\$440</u>	<u>\$416</u>	<u>\$440</u>	<u>\$416</u>

Net outflows (excluding money markets) in the quarter and six month period ended May 31, 2006 were primarily associated with the Company's Morgan Stanley branded products, partially offset by positive institutional flows. Net outflows in the six month period ended May 31, 2006 also reflected distributions of assets from the private equity business. For the quarter and six month period ended May 31, 2006, net outflows from Asset Management's money market assets were primarily associated with two retail funds impacted by Global Wealth Management Group's bank deposit program. The net outflows in the six month period ended May 31, 2006 were partially offset by market appreciation and positive flows into institutional liquidity assets.

Asset management, distribution and administration fees increased 1% and 3% in the quarter and six month period ended May 31, 2006, as higher fund management and administration fees associated with a 6% and 4% increase

in average assets under management in the quarter and six month period, respectively, were partly offset by lower distribution and redemption fees. The increase in the six month period was also due to higher performance fees.

***Non-Interest Expenses.*** Non-interest expenses increased 7% and 17% in the quarter and six month period ended May 31, 2006. The increase in both periods primarily reflected an increase in compensation and benefits expense, partially offset by lower non-compensation expenses. The six month period ended May 31, 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 "Insurance Settlement" herein). Compensation and benefits expense increased 51% and 44% in the quarter and six month period, primarily reflecting higher incentive-based compensation accruals. The six month period ended May 31, 2006 also included Asset Management's share (\$28 million) of the incremental compensation expense related to equity awards to retirement-eligible employees (see "Stock Based-Compensation" herein). Excluding compensation and benefits expense and the insurance settlement, non-interest expenses decreased 18% and 8% in the quarter and six month period. Brokerage, clearing and exchange fees decreased 9% and 13% in the quarter and six month period, 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 12% in the six month period primarily due to higher promotional costs associated with the Company's Van Kampen products. Professional services expense decreased 13% in the quarter primarily due to lower sub-advisory fees. Other expenses decreased 129% and 61% in the quarter and six month period, primarily due to an insurance reimbursement related to certain legal matters.

**DISCOVER**  
**INCOME STATEMENT INFORMATION**

	<b>Three Months Ended May 31,</b>		<b>Six Months Ended May 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(dollars in millions)</b>			
Merchant, cardmember and other fees . . . . .	\$ 277	\$318	\$ 566	\$ 626
Servicing and securitization income . . . . .	651	423	1,247	917
Other revenue . . . . .	5	2	9	4
Total non-interest revenues . . . . .	933	743	1,822	1,547
Interest revenue . . . . .	608	536	1,194	994
Interest expense . . . . .	220	182	451	350
Net interest income . . . . .	388	354	743	644
Provision for consumer loan losses . . . . .	130	209	285	344
Net credit income . . . . .	258	145	458	300
Net revenues . . . . .	1,191	888	2,280	1,847
Total non-interest expenses . . . . .	650	625	1,260	1,230
Income before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net . . . . .	541	263	1,020	617
Losses from unconsolidated investees . . . . .	—	—	1	—
Provision for income taxes . . . . .	203	99	381	233
Income before cumulative effect of accounting change, net . . . . .	<u>\$ 338</u>	<u>\$164</u>	<u>\$ 638</u>	<u>\$ 384</u>

**Merchant, Cardmember and Other Fees.** Merchant, cardmember and other fees decreased 13% and 10% in the quarter and six month period ended May 31, 2006, primarily due to lower net merchant discount revenues and higher net cardmember rewards, partially offset by higher merchant and cardmember fees. The decrease in net merchant discount revenues was due to higher allocations of interchange revenue to securitization transactions, partially offset by record sales volume. For securitization transactions completed on or after November 3, 2004, the Company began allocating interchange revenue to new securitization transactions, which has the effect of decreasing Merchant, cardmember and other fees and increasing Servicing and securitization income. During the quarter and six month period ended May 31, 2006, the Company had a higher level of outstanding securitization transactions receiving interchange allocations than in the comparable fiscal 2005 periods. The increase in sales volume reflected increased cardmember usage and the acquisition of Goldfish in February 2006 (see “Business Acquisitions” herein). The increase in net cardmember rewards reflected record sales volume and the impact of promotional programs. The increase in merchant and cardmember fees primarily relates to lower fee net charge-offs and higher revenues from merchant fees.

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
	(dollars in millions)			
Merchant, cardmember and other fees .....	\$264	\$166	\$ 494	\$ 339
Other revenue .....	17	(16)	156	16
Total non-interest revenues .....	281	150	650	355
Interest revenue .....	968	890	1,857	1,815
Interest expense .....	356	251	666	484
Net interest income .....	612	639	1,191	1,331
Provision for consumer loan losses .....	242	366	594	769
Net credit income .....	370	273	597	562
Servicing and securitization income .....	<u>\$651</u>	<u>\$423</u>	<u>\$1,247</u>	<u>\$ 917</u>

Servicing and securitization income increased 54% and 36% in the quarter and six month period ended May 31, 2006, primarily due to higher non-interest revenues and a lower provision for consumer loan losses. The increase in Merchant, cardmember and other fees primarily reflected a higher level of outstanding securitization transactions that received interchange revenues. The increase in Other revenue in both periods was attributable to an increase in the fair value of the Company's retained interests in securitized receivables, primarily resulting from a favorable impact on charge-offs following the enactment of federal bankruptcy legislation that became effective in October 2005. The increase in Other revenue in the six month period also reflected higher levels of general purpose credit card securitization transactions. The lower provision for consumer loan losses in both periods was primarily attributable to a lower level of average securitized general purpose credit card loans and a lower rate of net principal charge-offs on the securitized general purpose credit card loan portfolio. The increase in Servicing and securitization income in the six month period was partially offset by a decrease in net interest cash flows primarily attributable to a lower level of average securitized general purpose credit card loans.

The net proceeds received from general purpose credit card asset securitizations in the six month periods ended May 31, 2006 and 2005 were \$6,613 million and \$3,419 million, respectively. The credit card asset securitization transactions completed in the six month period ended May 31, 2006 have expected maturities ranging from approximately three to seven years from the date of issuance.

**Net Interest Income.** Net interest income increased 10% and 15% in the quarter and six month period ended May 31, 2006 due to an increase in interest revenue, partially offset by an increase in interest expense. The increase in interest revenue in both periods was due to an increase in average owned general purpose credit card loans as well as a higher interest yield. The increase in average owned general purpose credit card loans was due to the acquisition of Goldfish (see "Business Acquisitions" herein) and a lower level of outstanding securitizations. The increase in interest expense in both periods was primarily due to an increase in the Company's average cost of borrowings and a higher level of average interest bearing liabilities, primarily to support the increase in average owned general purpose credit card loans.

The following tables present analyses of Discover's average balance sheets and interest rates for the quarters and six months ended May 31, 2006 and 2005 and changes in net interest income during those periods:

**Average Balance Sheet Analysis.**

	Three Months Ended May 31,					
	2006			2005		
	Average Balance	Rate	Interest (dollars in millions)	Average Balance	Rate	Interest
<b>ASSETS</b>						
Interest earning assets:						
General purpose credit card loans	\$19,664	11.01%	\$ 546	\$18,753	10.56%	\$ 499
Other consumer loans	214	7.43	4	404	7.53	8
Investment securities	59	3.97	1	52	1.78	—
Other	4,265	5.32	57	3,294	3.46	29
Total interest earning assets	24,202	9.95	608	22,503	9.45	536
Allowance for loan losses	(785)			(848)		
Non-interest earning assets	2,682			2,475		
Total assets	<u>\$26,099</u>			<u>\$24,130</u>		
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	\$ 1,579	4.54%	\$ 18	\$ 656	2.57%	\$ 4
Brokered	10,931	4.55	125	9,933	4.37	109
Other time	1,759	4.49	20	2,374	3.63	22
Total interest bearing deposits	14,269	4.54	163	12,963	4.15	135
Other borrowings	4,689	4.80	57	4,689	3.93	47
Total interest bearing liabilities	18,958	4.60	220	17,652	4.09	182
Shareholder's equity/other liabilities	7,141			6,478		
Total liabilities and shareholder's equity	<u>\$26,099</u>			<u>\$24,130</u>		
Net interest income			<u>\$ 388</u>			<u>\$ 354</u>
Net interest margin(1)			6.35%			6.24%
Interest rate spread(2)		5.35%			5.36%	

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

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

## Average Balance Sheet Analysis.

	Six Months Ended May 31,					
	2006			2005		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
	(dollars in millions)					
<b>ASSETS</b>						
Interest earning assets:						
General purpose credit card loans . . . . .	\$20,808	10.41%	\$1,080	\$18,979	9.81%	\$ 929
Other consumer loans . . . . .	260	7.48	10	403	7.65	15
Investment securities . . . . .	49	3.86	1	54	1.66	1
Other . . . . .	4,149	5.00	103	2,920	3.37	49
	<u>25,266</u>	9.48	1,194	<u>22,356</u>	8.91	994
Total interest earning assets . . . . .						
Allowance for loan losses . . . . .	(811)			(893)		
Non-interest earning assets . . . . .	2,423			2,599		
	<u>\$26,878</u>			<u>\$24,062</u>		
Total assets . . . . .						
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>						
Interest bearing liabilities:						
Interest bearing deposits						
Savings . . . . .	\$ 1,203	4.31%	\$ 26	\$ 651	2.33%	\$ 8
Brokered . . . . .	11,655	4.50	262	9,382	4.45	208
Other time . . . . .	1,771	4.45	39	2,742	3.38	46
	<u>14,629</u>	4.48	327	<u>12,775</u>	4.11	262
Total interest bearing deposits . . . . .						
Other borrowings . . . . .	5,338	4.67	124	4,731	3.72	88
	<u>19,967</u>	4.53	451	<u>17,506</u>	4.01	350
Total interest bearing liabilities . . . . .						
Shareholder's equity/other liabilities . . . . .	6,911			6,556		
	<u>\$26,878</u>			<u>\$24,062</u>		
Total liabilities and shareholder's equity . . . . .						
Net interest income . . . . .			<u>\$ 743</u>			<u>\$ 644</u>
Net interest margin(1) . . . . .			5.90%			5.78%
Interest rate spread(2) . . . . .		4.95%			4.90%	

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

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

## Rate/Volume Analysis.

Increase/(Decrease) due to Changes in:	Three Months Ended May 31, 2006 vs. 2005			Six Months Ended May 31, 2006 vs. 2005		
	Volume	Rate	Total	Volume	Rate	Total
	(dollars in millions)					
<b>Interest Revenue</b>						
General purpose credit card loans . . . . .	\$ 25	\$ 22	\$47	\$ 91	\$ 60	\$151
Other consumer loans . . . . .	(4)	—	(4)	(5)	—	(5)
Investment securities . . . . .	1	—	1	—	—	—
Other . . . . .	8	20	28	21	33	54
Total interest revenue . . . . .	41	31	72	131	69	200
<b>Interest Expense</b>						
Interest bearing deposits:						
Savings . . . . .	6	8	14	6	12	18
Brokered . . . . .	11	5	16	51	3	54
Other time . . . . .	(6)	4	(2)	(16)	9	(7)
Total interest bearing deposits . . . . .	14	14	28	39	26	65
Other borrowings . . . . .	—	10	10	11	25	36
Total interest expense . . . . .	13	25	38	49	52	101
Net interest income . . . . .	<u>\$ 28</u>	<u>\$ 6</u>	<u>\$34</u>	<u>\$ 82</u>	<u>\$ 17</u>	<u>\$ 99</u>

**Provision for Consumer Loan Losses.** The provision for consumer loan losses decreased 38% and 17% in the quarter and six month period ended May 31, 2006. The decrease in both periods reflected lower net charge-offs primarily related to a decline in bankruptcy filings following the federal bankruptcy legislation that became effective in October 2005 and improved portfolio credit quality resulting in a higher net release of reserves as compared with the prior year periods. The net reduction in reserves was \$21 million and \$118 million in the quarter and six month period ended May 31, 2006, respectively, as compared with \$11 million and \$101 million in the comparable prior year periods, respectively.

**Delinquencies and Charge-offs.** Delinquency rates in both the over 30- and over 90-day categories and net principal charge-off rates were lower for both the owned and managed portfolios, reflecting improvements in portfolio credit quality and the favorable impact following the enactment of federal bankruptcy legislation (see “Managed General Purpose Credit Card Loan Data” herein). While pressure on the consumer continues from higher interest rates, inflation and the increased minimum payment requirements discussed below, there have been no meaningful signs of this pressure in the Company’s U.S. portfolio performance. In addition, although consumer bankruptcy filings remain well below historical levels, the Company expects charge-offs in the Discover segment to rise from the low second quarter levels, but remain below 5% on a managed basis, as pressures on consumers continue and bankruptcies begin to return to more normalized levels in the second half of fiscal 2006.

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

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

**Non-Interest Expenses.** Non-interest expenses increased 4% and 2% in the quarter and six month period ended May 31, 2006. Compensation and benefits expense increased 7% and 10% in the quarter and six month period, primarily reflecting higher incentive-based compensation accruals. The six month period ended May 31, 2006 included Discover's share (\$17 million) of the incremental compensation expense related to equity awards to retirement-eligible employees (see "Stock Based-Compensation" herein). Excluding compensation and benefits expense, non-interest expenses increased 2% in the quarter and decreased 2% in the six month period. Marketing and business development expenses decreased 8% and 13% in the quarter and six month period due to lower marketing and advertising costs. Professional services expenses increased 26% and 11% in the quarter and six month period primarily due to an increase in legal and consulting fees associated with the acquisition of Goldfish.

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

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

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

Three Months Ended May 31,								
2006					2005			
Average Balance	Return on Receivables(1)	Interest Yield	Interest Rate Spread		Average Balance	Return on Receivables(1)	Interest Yield	Interest Rate Spread
<b>General Purpose Credit Card Loans:</b>								
Owned .....	\$19,664	6.83%	11.01%	6.41%	\$18,753	3.48%	10.56%	6.47%
Securitized .....	27,643	4.86%	13.89%	8.76%	28,393	2.30%	12.43%	8.92%
Managed .....	<u>\$47,307</u>	2.84%	12.69%	7.78%	<u>\$47,146</u>	1.38%	11.69%	7.96%
Six Months Ended May 31,								
2006					2005			
Average Balance	Return on Receivables(1)	Interest Yield	Interest Rate Spread		Average Balance	Return on Receivables(1)	Interest Yield	Interest Rate Spread
<b>General Purpose Credit Card Loans:</b>								
Owned .....	\$20,808	6.15%	10.41%	5.89%	\$18,979	4.06%	9.81%	5.80%
Securitized .....	26,631	4.80%	13.98%	8.97%	29,049	2.65%	12.53%	9.20%
Managed .....	<u>\$47,439</u>	2.70%	12.42%	7.61%	<u>\$48,028</u>	1.60%	11.46%	7.87%

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



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

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

[illegible]

## **Other Items.**

### **Stock-Based Compensation.**

The Company early adopted Statement of Financial Accounting Standards (“SFAS”) No. 123R, “Share-Based Payment,” using the modified prospective approach as of December 1, 2004. SFAS No. 123R revised the fair value-based method of accounting for share-based payment liabilities, forfeitures and modifications of stock-based awards and clarified guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to service periods. Upon adoption, the Company recognized an \$80 million gain (\$49 million after-tax) as a cumulative effect of a change in accounting principle in the first quarter of fiscal 2005 resulting from the requirement to estimate forfeitures at the date of grant instead of recognizing them as incurred. The cumulative effect gain increased both basic and diluted earnings per share by \$0.05.

For stock-based awards issued prior to the adoption of SFAS No. 123R, the Company’s accounting policy for awards granted to retirement-eligible employees was to recognize compensation cost over the service period specified in the award terms. The Company accelerates any unrecognized compensation cost for such awards if and when a retirement-eligible employee leaves the Company. For stock-based awards made to retirement-eligible employees during fiscal 2005, the Company recognized compensation expense for such awards on the date of grant.

For fiscal 2005 year-end stock-based compensation awards that were granted to retirement-eligible employees in December 2005, the Company recognized the compensation cost for such awards at the date of grant instead of over the service period specified in the award terms. As a result, the Company recorded non-cash incremental compensation expenses of approximately \$395 million in the first quarter of fiscal 2006 for stock-based awards granted to retirement-eligible employees as part of the fiscal 2005 year-end award process and for awards granted to retirement-eligible employees, including new hires, in the first quarter of fiscal 2006. These incremental expenses were included within Compensation and benefits expense and reduced income before taxes within the Institutional Securities (\$270 million), Global Wealth Management Group (\$80 million), Asset Management (\$28 million) and Discover (\$17 million) business segments.

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 will be 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 (currently scheduled to occur in December 2006).

### **Discontinued Operations.**

On January 30, 2006, the Company announced that it had signed a definitive agreement under which it would sell its aircraft leasing business to Terra Firma, a European private equity group, for approximately \$2.5 billion in cash and the assumption of liabilities. The sale was completed on March 24, 2006. The results for discontinued operations in the quarter ended February 28, 2006 include a loss of \$125 million (\$75 million after-tax) related to the impact of the finalization of the sales proceeds and balance sheet adjustments related to the closing (see Note 15 to the condensed consolidated financial statements).

The quarter and six month period of fiscal 2006 reflected net income of \$8 million and a net loss of \$25 million on discontinued operations, respectively. The results for the second quarter of fiscal 2006 reflected the results of operations of the aircraft leasing business through the date of sale.

### **Business Acquisitions.**

On February 17, 2006, the Company completed the acquisition of the Goldfish credit card business in the U.K. The Company believes that the acquisition of Goldfish will add economies of scale through better utilization of the existing U.K. infrastructure and strengthen its position in the U.K. credit card market. Since the acquisition

date, the results of Goldfish have been included within the Discover business segment. The acquisition price was approximately \$1,676 million, which was paid in cash during February 2006. The Company recorded goodwill and other intangible assets of approximately \$355 million in connection with the acquisition. The acquisition price is still subject to finalization, and the allocation of the price is preliminary and is subject to further adjustment as the valuation of certain intangible assets is still in process (see Note 16 to the condensed consolidated financial statements).

#### **Coleman Litigation.**

In the first quarter of fiscal 2005, the Company recorded a \$360 million charge related to the Coleman litigation matter (See Note 8 to the condensed consolidated financial statements). For further information, refer to “Legal Proceedings” in Part I, Item 3 of the Form 10-K, “Legal Proceedings” in Part II, Item 1 herein, and “Financial Statements and Supplementary Data—Note 9” in Part II, Item 8 of the Form 10-K.

#### **Insurance Settlement.**

On September 11, 2001, the U.S. experienced terrorist attacks targeted against New York City and Washington, D.C. The attacks in New York resulted in the destruction of the World Trade Center complex, where approximately 3,700 of the Company’s employees were located, and the temporary closing of the debt and equity financial markets in the U.S. Through the implementation of its business recovery plans, the Company relocated its displaced employees to other facilities.

In the first quarter of fiscal 2005, the Company settled its claim with its insurance carriers related to the events of September 11, 2001. The Company recorded a pre-tax gain of \$251 million as the insurance recovery was in excess of previously recognized costs related to the terrorist attacks (primarily write-offs of leasehold improvements and destroyed technology and telecommunications equipment in the World Trade Center complex, employee relocation and certain other employee-related expenditures).

The pre-tax gain was recorded as a reduction to non-interest expenses and is included within Global Wealth Management Group (\$198 million), Asset Management (\$43 million) and Institutional Securities (\$10 million) segments. The insurance settlement was allocated to the respective segments in accordance with the relative damages sustained by each segment.

#### **Lease Adjustment.**

Prior to the first quarter of fiscal 2005, the Company did not record the effects of scheduled rent increases and rent-free periods for certain real estate leases on a straight-line basis. In addition, the Company had been accounting for certain tenant improvement allowances as reductions to the related leasehold improvements instead of recording funds received as deferred rent and amortizing them as reductions to lease expense over the lease term. In the first quarter of fiscal 2005, the Company changed its method of accounting for these rent escalation clauses, rent-free periods and tenant improvement allowances to properly reflect lease expense over the lease term on a straight-line basis. The impact of this correction resulted in the Company recording \$109 million of additional rent expense in the first quarter of fiscal 2005. The impact of this change was included within non-interest expenses and reduced income before taxes within the Institutional Securities (\$71 million), Global Wealth Management Group (\$29 million), Asset Management (\$5 million) and Discover (\$4 million) segments. The impact of this correction to the six month period of fiscal 2005 was not material to the pre-tax income of each of the segments or to the Company.

#### **Income Tax Examinations.**

The Company is under continuous examination by the Internal Revenue Service (the “IRS”) and other tax authorities in certain countries, such as Japan and the U.K., and states in which the Company has significant

business operations, such as New York. The tax years under examination vary by jurisdiction; for example, the current IRS examination, which recently began, covers 1999-2004. The Company has filed an appeal with respect to unresolved issues relative to the IRS examination of years 1994-1998. The Company believes that the settlement of the IRS examination of years 1994-1998 will not have a material negative impact on the condensed consolidated statement of income of the Company. The Company regularly assesses the likelihood of additional assessments in each of the taxing jurisdictions resulting from these and subsequent years' examinations. The Company has established tax reserves that the Company believes are adequate in relation to the potential for additional assessments. Once established, the Company adjusts tax reserves only when more information is available or when an event occurs necessitating a change to the reserves. The Company believes that the resolution of tax matters will not have a material effect on the condensed consolidated financial condition of the Company, although a resolution could have a material impact on the Company's condensed consolidated statement of income for a particular future period and on the Company's effective income tax rate for any period in which such resolution occurs.

### **Accounting Developments.**

#### *Limited Partnerships.*

In June 2005, the Financial Accounting Standards Board ("FASB") ratified the consensus reached in Emerging Issues Task Force ("EITF") Issue No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights." Under the provisions of EITF Issue No. 04-5, a general partner in a limited partnership is presumed to control that limited partnership and therefore should include the limited partnership in its consolidated financial statements regardless of the amount or extent of the general partner's interest unless a majority of the limited partners can vote to dissolve or liquidate the partnership or otherwise remove the general partner without having to show cause or the limited partners have substantive participating rights that can overcome the presumption of control by the general partner. EITF Issue No. 04-5 was effective immediately for all newly formed limited partnerships and existing limited partnerships for which the partnership agreements have been modified. For all other existing limited partnerships for which the partnership agreements have not been modified, the Company is required to adopt EITF Issue No. 04-5 on December 1, 2006 in a manner similar to a cumulative-effect-type adjustment or by retrospective application. The Company is currently assessing the impact on these existing limited partnerships of adopting the provisions of EITF Issue No. 04-5; however, because the Company generally expects to provide limited partners in these funds with rights to remove the Company as general partner or rights to terminate the partnership, the Company does not expect the impact of EITF Issue No. 04-5 to be material.

#### *Accounting for Certain Hybrid Financial Instruments.*

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments," which amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 155 permits hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation to irrevocably be accounted for at fair value, with changes in fair value recognized in the statement of income. The fair value election may be applied on an instrument-by-instrument basis. SFAS No. 155 also eliminates a restriction on the passive derivative instruments that a qualifying special purpose entity may hold. For the Company, SFAS No. 155 is effective for those financial instruments acquired or issued after December 1, 2006. At adoption, any difference between the total carrying amount of the individual components of the existing bifurcated hybrid financial instrument and the fair value of the combined hybrid financial instrument will be recognized as a cumulative-effect adjustment to beginning retained earnings. The Company is currently evaluating the potential impact of adopting SFAS No. 155.

#### *Accounting for Servicing of Financial Assets.*

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140." SFAS No. 156 requires all separately recognized servicing assets and servicing

liabilities to be initially measured at fair value, if practicable. The standard permits an entity to subsequently measure each class of servicing assets or servicing liabilities at fair value and report changes in fair value in the statement of income in the period in which the changes occur. SFAS No. 156 is effective for the Company as of December 1, 2006. The Company is currently evaluating the potential impact of adopting SFAS No. 156.

*Determining the Variability in Variable Interest Entities.*

In April 2006, the FASB issued FASB Staff Position No. FIN 46(R)-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)" ("FSP FIN 46(R)-6"). FSP FIN 46(R)-6 requires that the determination of the variability to be considered in applying FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" ("FIN 46R"), be based on an analysis of the design of the entity. In evaluating whether an interest with a variable interest entity creates or absorbs variability, FSP FIN 46(R)-6 focuses on the role of a contract or arrangement in the design of an entity, regardless of its legal form or accounting classification. The Company will adopt the guidance in FSP FIN 46(R)-6 prospectively beginning September 1, 2006 to all entities that the Company first becomes involved with and to all entities previously required to be analyzed under FIN 46R when a reconsideration event has occurred under paragraph 7 of FIN 46R. The Company does not expect the adoption of FSP FIN 46(R)-6 to have a material impact on its condensed consolidated financial statements.

**Subsequent Events.**

*Office Building.* In June 2006, the Company purchased a significant interest in a joint venture that indirectly owns title to 522 Fifth Avenue, a 23-floor office building in New York City (the "Building"), for approximately \$420 million. Concurrently, the Company entered into an occupancy agreement with the joint venture pursuant to which the Company will occupy the office space in the Building (approximately 580,000 square feet).

*TransMontaigne Inc.* In June 2006, Morgan Stanley Capital Group Inc., a wholly-owned subsidiary of the Company, entered into a definitive Agreement and Plan of Merger to effect the acquisition of TransMontaigne Inc., a Denver-based company that operates pipelines, terminals and barges, and distributes and markets refined petroleum products. The Company will purchase the outstanding common shares of TransMontaigne Inc. for \$11.35 per share, or an aggregate cost of approximately \$610 million. The transaction is subject to customary closing conditions and is expected to be completed during the third or fourth quarter of fiscal 2006.

*Preferred Stock.* In July 2006, the Company issued \$1 billion of Floating Rate Non-Cumulative Preferred Stock, Series A.

## **Critical Accounting Policies.**

The condensed consolidated financial statements are prepared in accordance with U.S. GAAP, which requires the Company to make estimates and assumptions (see Note 1 to the condensed consolidated financial statements). The Company believes that of its accounting policies (see Note 2 to the consolidated financial statements for the fiscal year ended November 30, 2005 included in the Form 10-K), the following involve a higher degree of judgment and complexity.

### **Financial Instruments Used For Trading and Investment.**

Financial instruments owned and Financial instruments sold, not yet purchased, which include cash and derivative products, are recorded at fair value in the condensed consolidated statements of financial condition, and gains and losses are reflected in Principal trading and investment revenues in the condensed consolidated statements of income. Fair value is the amount at which financial instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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

A substantial percentage of the fair value of the Company's Financial instruments owned and Financial instruments sold, not yet purchased is based on observable market prices, observable market parameters, or is derived from such prices or parameters. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing parameters in a product (or a related product) may be used to derive a price without requiring significant judgment. In certain markets, observable market prices or market parameters are not available for all products, and fair value is determined using techniques appropriate for each particular product. These techniques involve some degree of judgment.

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

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



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

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

The following table presents the valuation of the Company's cash products included within Financial instruments owned and Financial instruments sold, not yet purchased by level of price transparency (dollars in millions):

	At May 31, 2006		At November 30, 2005	
	Assets	Liabilities	Assets	Liabilities
Observable market prices, parameters or derived from observable prices or parameters .....	\$238,640	\$110,669	\$203,590	\$101,972
Reduced or no price transparency .....	19,995	406	11,131	76
Total .....	<u>\$258,635</u>	<u>\$111,075</u>	<u>\$214,721</u>	<u>\$102,048</u>

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

The following table presents the fair value of the Company's exchange traded and OTC derivatives included within Financial instruments owned and Financial instruments sold, not yet purchased (dollars in millions):

	At May 31, 2006		At November 30, 2005	
	Assets	Liabilities	Assets	Liabilities
Exchange traded .....	\$ 6,715	\$10,213	\$ 4,491	\$ 8,151
OTC .....	44,821	38,534	41,403	36,801
Total .....	<u>\$51,536</u>	<u>\$48,747</u>	<u>\$45,894</u>	<u>\$44,952</u>

The fair value of OTC derivative contracts is derived primarily using pricing models, which may require multiple market input parameters. Where appropriate, valuation adjustments are made to account for credit quality and market liquidity. These adjustments are applied on a consistent basis and are based upon observable market data

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

Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets, as is the case for generic interest rate swap and option contracts. A substantial majority of OTC derivative products valued by the Company using pricing models fall into this category. Other derivative products, typically the newest and most complex products, will require more judgment in the implementation of the modeling technique applied due to the complexity of the modeling assumptions and the reduced price transparency surrounding the model's market parameters. The Company manages its market exposure for OTC derivative products primarily by entering into offsetting derivative contracts or other related financial instruments. The Company's trading divisions, the Financial Control Department and the Market Risk Department continuously monitor the price changes of the OTC derivatives in relation to the offsetting positions. For a further discussion of the price transparency of the Company's OTC derivative products, see "Quantitative and Qualitative Disclosures about Market Risk—Risk Management—Credit Risk" in Part II, Item 7A of the Form 10-K.

Equity and debt securities purchased in connection with private equity and other principal investment activities initially are carried in the condensed consolidated financial statements at their original costs, which approximate fair value. The carrying value of such securities is adjusted when changes in the underlying fair values are readily ascertainable, generally as evidenced by observable market prices or transactions that directly affect the value of such securities. Downward adjustments relating to such securities are made in the event that the Company determines that the fair value is less than the carrying value. The Company's partnership interests, including general partnership and limited partnership interests in real estate funds, are included within Other assets in the condensed consolidated statements of financial condition and are recorded at fair value based upon changes in the fair value of the underlying partnership's net assets.

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



information is then used to evaluate the fair value of these OTC derivative products. For more information regarding the Company's risk management practices, see "Quantitative and Qualitative Disclosures about Market Risk—Risk Management" in Part II, Item 7A of the Form 10-K.

#### **Allowance for Consumer Loan Losses.**

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

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

#### **Legal, Regulatory and Tax Contingencies.**

In the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or in financial distress. The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company's business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number of these reviews, investigations and proceedings has increased in recent years with regard to many firms in the financial services industry, including the Company.

Reserves for litigation and regulatory proceedings are generally determined on a case-by-case basis and represent an estimate of probable losses after considering, among other factors, the progress of each case, prior experience and the experience of others in similar cases, and the opinions and views of internal and external legal counsel. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss, if any, related to such matters, how 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 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 must also make estimates about when in the future certain items affect taxable income in the various tax jurisdictions. Disputes over interpretations of the tax laws may be settled with the taxing authority upon examination or audit. The Company regularly assesses the likelihood of assessments in each of the taxing jurisdictions resulting from current and subsequent years' examinations, and tax reserves are established as appropriate.

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

See Notes 8 and 17 to the condensed consolidated financial statements for additional information on legal proceedings and income tax examinations.

## **Liquidity and Capital Resources.**

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

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

For a more detailed summary of the Company's Liquidity and Capital Policies and funding sources, including committed credit facilities and off-balance sheet funding, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" in Part II, Item 7 of the Form 10-K.

### **The Balance Sheet.**

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

The Company's total assets increased to \$1,027.0 billion at May 31, 2006 from \$898.5 billion at November 30, 2005. The increase was primarily due to increases in financial instruments owned (largely driven by increases in corporate and other debt and corporate equities), receivables from customers, securities borrowed and securities received as collateral. The increase was also due to an increase in securities purchased under agreements to resell, partially offset by a decrease in cash and cash equivalents. The increases were largely the result of higher market volatility globally and an increase in client business opportunities.

Balance sheet leverage ratios are one indicator of capital adequacy when viewed in the context of a company's overall liquidity and capital policies. The Company views the adjusted leverage ratio as a more relevant measure of financial risk when comparing financial services firms and evaluating leverage trends. The Company has adopted a definition of adjusted assets that excludes certain self-funded assets considered to have minimal market, credit and/or liquidity risk. These low-risk assets generally are attributable to the Company's matched book and securities lending businesses. Adjusted assets are calculated by reducing gross assets by aggregate resale agreements and securities borrowed less non-derivative short positions and assets recorded under certain provisions of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities—a replacement of FASB Statement No. 125," and FIN 46R. 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 40 year final maturity at issuance), the Company's ability to defer coupon interest for up to 20 consecutive quarters and the subordinated nature of the obligations in the capital structure. The Company also receives rating agency equity credit for these securities.

The following table sets forth the Company's total assets, adjusted assets and leverage ratios as of May 31, 2006 and November 30, 2005 and for the average month-end balances during the quarter and six month period ended May 31, 2006:

	Balance at		Average Month-End Balance	
	May 31, 2006	November 30, 2005	For the Quarter Ended May 31, 2006	For the Six Month Period Ended May 31, 2006
	(dollars in millions, except ratio data)			
Total assets	\$1,027,043	\$ 898,523	\$1,002,868	\$ 977,807
Less: Securities purchased under agreements to resell	(190,289)	(174,330)	(184,035)	(185,924)
Securities borrowed	(274,581)	(244,241)	(265,446)	(260,558)
Add: Financial instruments sold, not yet purchased	159,822	147,000	155,342	151,227
Less: Derivative contracts sold, not yet purchased	(48,747)	(44,952)	(46,366)	(45,474)
Subtotal	673,248	582,000	662,363	637,078
Less: Segregated customer cash and securities balances	(31,685)	(30,540)	(28,195)	(28,889)
Assets recorded under certain provisions of SFAS No. 140 and FIN 46R	(90,046)	(67,091)	(83,284)	(77,800)
Goodwill and net intangible assets	(2,932)	(2,500)	(2,899)	(2,731)
Adjusted assets	\$ 548,585	\$ 481,869	\$ 547,985	\$ 527,658
Shareholders' equity	\$ 32,255	\$ 29,182	\$ 31,182	\$ 30,412
Junior subordinated debt issued to capital trusts	3,473	2,764	3,538	3,336
Subtotal	35,728	31,946	34,720	33,748
Less: Goodwill and net intangible assets	(2,932)	(2,500)	(2,898)	(2,731)
Tangible shareholders' equity	\$ 32,796	\$ 29,446	\$ 31,822	\$ 31,017
Leverage ratio(1)	31.3x	30.5 x	31.5x	31.5x
Adjusted leverage ratio(2)	16.7x	16.4 x	17.2x	17.0x

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

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

#### Activity in the Six Month Period Ended May 31, 2006.

The Company's total capital consists of shareholders' equity, long-term borrowings (debt obligations scheduled to mature in more than 12 months), junior subordinated debt issued to capital trusts, and Capital Units. At May 31, 2006, total capital was \$145.7 billion, an increase of \$19.8 billion from November 30, 2005.

During the six month period ended May 31, 2006, the Company issued senior notes aggregating \$26.5 billion, including non-U.S. dollar currency notes aggregating \$11.5 billion and \$889 million of junior subordinated debentures. At May 31, 2006, the aggregate outstanding principal amount of the Company's Senior Indebtedness (as defined in the Company's debt indentures) was approximately \$149 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 five years at May 31, 2006.

During the six month period ended May 31, 2006, the Company purchased approximately \$1,312 million of its common stock (approximately 22 million shares) through open market purchases at an average cost of \$59.47 (see also “Unregistered Sales of Equity Securities and Use of Proceeds” in Part II, Item 2). During fiscal 2006, the Company currently anticipates that repurchases of its common stock pursuant to its equity antidilution program will be approximately \$2 billion or less.

Subsequent to quarter-end, on July 6, 2006, the Company issued \$1 billion of Floating Rate Non-Cumulative Preferred Stock, Series A.

### **Economic Capital.**

The Company uses an economic capital model to determine the amount of equity capital needed to support the risk of its business activities and to ensure that the Company remains adequately capitalized. The Company calculates economic capital on a going concern basis, which is defined as the amount of capital needed to run the business through the business cycle and satisfy the requirements of regulators, rating agencies and the market. Business unit economic capital allocations are evaluated by benchmarking to similarly rated peer firms by business segment. The Company believes this methodology provides an indication of the appropriate level of capital for each business segment as if each were an independent operating entity.

Economic capital requirements are allocated to each business segment and are sub-allocated to product lines as appropriate. This process is intended to align equity capital with the risks in each business, provide business managers with tools for measuring and managing risk, and allow senior management to evaluate risk-adjusted returns (such as return on economic capital and shareholder value added) to facilitate resource allocation decisions.

The Company’s methodology is based on an approach that assigns economic capital to each business unit based on regulatory capital usage plus additional capital for stress losses. Regulatory capital, including additional capital assigned for goodwill, intangible assets and principal investment risk, is a minimum requirement to ensure funding access and customer credibility. The Company believes it must be able to sustain stress losses and maintain capital substantially above regulatory minimums while supporting ongoing business activities. Aggregate economic capital requirements represent the minimum amount of book equity capital required under the going concern approach. The difference between the Company’s consolidated common equity and aggregate economic capital denotes the Company’s unallocated capital position, which is not currently allocated to the business segments or reflected in business segment performance metrics.

The Company assesses stress loss capital across various dimensions of market, credit, business and operational risks. Stress losses are defined at the 90% to 95% confidence interval in order to capture worst potential losses in 10 to 20 years. Stress loss calculations are tangible and transparent and avoid reliance on extreme loss statistical models.

Market risk scenarios capture systematic, idiosyncratic and random market risk through the use of internal market stress data. Credit risk is included in the form of idiosyncratic counterparty default events. Business risk incorporates earnings volatility due to variability in revenue flows, with estimates on the mix of fixed versus variable expenses at various points in the business cycle. Operational stress losses primarily reflect legal risk across the Company.

The Company may enhance the economic capital model and allocation methodology over time in response to changes in the business and regulatory environment to ensure that the model continues to reflect the risks inherent in the Company’s business activities and to reflect changes in the drivers of the level and cost of required capital.

The following table presents the Company's allocated average common equity (economic capital) during the quarters and six month periods ended May 31, 2006 and 2005:

	Three Months Ended May 31,		Six Months Ended May 31,	
	2006	2005	2006	2005
<b>Average common equity (dollars in billions):</b>				
Institutional Securities .....	\$18.1	\$14.3	\$17.1	\$14.1
Global Wealth Management Group .....	3.3	3.6	3.4	3.7
Asset Management .....	2.1	1.7	2.0	1.7
Discover .....	5.0	4.2	4.8	4.3
Total from operating segments .....	28.5	23.8	27.3	23.8
Discontinued operations .....	—	1.5	—	1.5
Unallocated capital .....	2.7	3.1	3.1	3.1
Consolidated .....	<u>\$31.2</u>	<u>\$28.4</u>	<u>\$30.4</u>	<u>\$28.4</u>

### Liquidity Management Policies.

The primary goal of the Company's liquidity and funding activities is to ensure adequate financing over a wide range of potential credit ratings and market environments. Given the highly liquid nature of the Company's balance sheet, day-to-day funding requirements are largely fulfilled through the use of stable collateralized financing. The Company has centralized management of credit-sensitive unsecured funding sources in the Treasury Department. In order to meet target liquidity requirements and withstand an unforeseen contraction in credit availability, the Company has designed a liquidity management framework.

<b>Liquidity Management Framework:</b>	<b>Designed to:</b>
Contingency Funding Plan	Ascertain the Company's ability to manage a prolonged liquidity contraction and provide a course of action over a one-year time period to ensure orderly functioning of the businesses. The contingency funding plan sets forth the process and the internal and external communication flows necessary to ensure effective management of the contingency event. Analytical processes exist to periodically evaluate and report the liquidity risk exposures of the organization under management-defined scenarios.
Cash Capital	Ensure that the Company can fund its balance sheet while repaying its financial obligations maturing within one year without issuing new unsecured debt. The Company attempts to achieve this by maintaining sufficient cash capital (long-term debt and equity capital) to finance illiquid assets and the portion of its securities inventory that is not expected to be financed on a secured basis in a credit-stressed environment.
Liquidity Reserve	Maintain, at all times, a liquidity reserve composed of immediately available cash and cash equivalents and a pool of unencumbered securities that can be sold or pledged to provide same-day liquidity to the Company. The reserve is periodically assessed and determined based on day-to-day funding requirements and strategic liquidity targets. The liquidity reserve averaged approximately \$42 billion for the six month period ended May 31, 2006, of which approximately \$36 billion on average was held at the parent company.



### **Liquidity Reserve.**

The Company seeks to maintain a target liquidity reserve that is sized to cover daily funding needs and to meet strategic liquidity targets, including coverage of a significant portion of expected cash outflows over a short-term horizon in a potential liquidity crisis. This liquidity reserve is held in the form of cash deposits with banks and a pool of unencumbered securities. The Company manages the pool of unencumbered securities, against which funding can be raised, on a global basis, and securities for the pool are chosen accordingly. The U.S. and non-U.S. components, held in the form of a reverse repurchase agreement at the parent company, consist primarily of U.S. and European government bonds and other high quality collateral and at May 31, 2006 were approximately \$28 billion and averaged approximately \$23 billion during the six month period ended May 31, 2006. The parent company cash component of the liquidity reserve at May 31, 2006 was approximately \$5 billion and averaged approximately \$13 billion for the six month period ended May 31, 2006. The Company believes that diversifying the form in which its liquidity reserve (cash and securities) is maintained enhances its ability to quickly and efficiently source funding in a stressed environment. The Company's funding requirements and target liquidity reserve may vary based on changes in the level and composition of its balance sheet, timing of specific transactions, client financing activity, market conditions and seasonal factors.

### **Committed Credit Facilities.**

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

During the quarter ended May 31, 2006, the Company restructured the Morgan Stanley and Morgan Stanley Japan Securities Co., Ltd. ("MSJS", as successor to the business of Morgan Stanley Japan Limited) Committed Revolving Credit Facility (the "MS-MSJS Facility"). The MS-MSJS Facility consists of three separate tranches: a U.S. dollar tranche with the Company as borrower; a Japanese yen tranche with MSJS as borrower and the Company as borrower and guarantor for MSJS borrowings; and a multicurrency tranche available in both euro and sterling with the Company as borrower. Under the MS-MSJS Facility, a group of banks is committed to provide up to \$7.5 billion under the U.S. dollar tranche; 80 billion Japanese yen under the Japanese yen tranche and \$3.25 billion under the multicurrency tranche. Concurrent with these changes, the Company terminated Morgan Stanley & Co. Incorporated's \$1.8 billion secured committed credit facility and Morgan Stanley & Co. International Limited's \$1.5 billion committed revolving credit facility. At May 31, 2006, the Company had a \$13.3 billion consolidated stockholders' equity surplus as compared with the MS-MSJS Facility's covenant requirement.

The Company anticipates that it may utilize the MS-MSJS Facility for short-term funding from time to time. The Company does not believe that any of the covenant requirements in the MS-MSJS Facility will impair its ability to obtain funding under the MS-MSJS Facility, to pay its current level of dividends, or to obtain loan arrangements, letters of credit or other financial accommodations. At May 31, 2006, no borrowings were outstanding under the MS-MSJS Facility.

### **Credit Ratings.**

The Company's reliance on external sources to finance a significant portion of its day-to-day operations makes access to global sources of financing important. The cost and availability of unsecured financing generally are dependent on the Company's short-term and long-term credit ratings. Factors that are significant to the determination of the Company's credit ratings or that otherwise affect its ability to raise short-term and long-term financing include the Company's level and volatility of earnings, relative positions in the markets in which it operates, geographic and product diversification, retention of key personnel, risk management policies, cash liquidity, capital structure, corporate lending credit risk, and legal and regulatory developments. In addition, continuing consolidation in the credit card industry presents Discover with stronger competitors that may

challenge future growth. A deterioration in any of the previously mentioned factors or combination of these factors may lead rating agencies to downgrade the credit ratings of the Company, thereby increasing the cost to the Company in obtaining unsecured funding. In addition, the Company's debt ratings can have a significant impact on certain trading revenues, particularly in those businesses where longer term counterparty performance is critical, such as OTC derivative transactions, including credit derivatives and interest rate swaps.

In connection with certain OTC trading agreements and certain other agreements associated with the Institutional Securities business, the Company would be required to provide additional collateral to certain counterparties in the event of a downgrade by either Moody's Investors Service or Standard & Poor's. At May 31, 2006, the amount of additional collateral that would be required in the event of a one-notch downgrade of the Company's senior debt credit rating was approximately \$1,369 million. Of this amount, \$474 million relates to bilateral arrangements between the Company and other parties where upon the downgrade of one party, the downgraded party must deliver incremental collateral to the other. These bilateral downgrade arrangements are a risk management tool used extensively by the Company as credit exposures are reduced if counterparties are downgraded.

As of June 30, 2006, the Company's credit ratings were as follows:

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

### Commitments.

The Company's commitments associated with outstanding letters of credit, investment activities, and corporate lending and financing commitments as of May 31, 2006 are summarized below by period of expiration. Since commitments associated with letters of credit and lending and financing arrangements may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Years to Maturity				
	Less than 1	1-3	3-5	Over 5	Total
	(dollars in millions)				
Letters of credit(1) .....	\$ 7,579	\$ 6	\$ —	\$ —	\$ 7,585
Investment activities .....	88	82	9	317	496
Investment grade corporate lending commitments(2) .....	4,764	5,132	14,636	2,556	27,088
Non-investment grade lending corporate commitments(2) ....	2,903	896	2,037	2,353	8,189
Commitments for secured lending transactions(3) .....	10,256	3,145	92	100	13,593
Commitments to purchase mortgage loans(4) .....	8,550	—	—	—	8,550
Total(5) .....	<u>\$34,140</u>	<u>\$9,261</u>	<u>\$16,774</u>	<u>\$5,326</u>	<u>\$65,501</u>

- (1) This amount represents the Company's outstanding letters of credit, which are primarily used to satisfy various collateral requirements.
- (2) The Company's investment grade and non-investment grade lending commitments are made in connection with its corporate lending activities. Credit ratings are determined by the Company's Institutional Credit Department using methodologies generally consistent with those employed by external rating agencies. Credit ratings of BB+ or lower are considered non-investment grade.
- (3) This amount represents lending commitments extended by the Company to companies that are secured by assets of the borrower. Loans made under these arrangements typically are at variable rates and generally provide for over-collateralization based upon the creditworthiness of the borrower.
- (4) This amount represents the Company's forward purchase contracts involving mortgage loans.
- (5) See Note 8 to the condensed consolidated financial statements.



The table above does not include commitments to extend credit for consumer loans of approximately \$273 billion. Such commitments arise primarily from agreements with customers for unused lines of credit on certain credit cards, provided there is no violation of conditions established in the related agreement. These commitments, substantially all of which the Company can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage and customer creditworthiness (see Note 4 to the condensed consolidated financial statements). In addition, in the ordinary course of business, the Company guarantees the debt and/or certain trading obligations (including obligations associated with derivatives, foreign exchange contracts and the settlement of physical commodities) of certain subsidiaries. These guarantees generally are entity or product specific and are required by investors or trading counterparties. The activities of the subsidiaries covered by these guarantees (including any related debt or trading obligations) are included in the Company's condensed consolidated financial statements.

At May 31, 2006, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately \$106 billion and \$82 billion, respectively.

### Investments.

The table below includes investments made by the Company that represent business facilitation or principal investing activities at May 31, 2006 and November 30, 2005 and are included within Other assets on the condensed consolidated statement of financial condition. Business facilitation investments are strategic investments undertaken by the Company to facilitate core business activities. Principal investing activities are capital investments in private companies, generally for proprietary purposes, to maximize total returns to the Company. The Company has committed to increasing its principal investing activity. The Company intends to make additional investments over time to bring the level of principal investments to approximately \$2.5 billion.

At May 31, 2006					
	Institutional Securities	Global Wealth Management Group	Asset Management	Discover	Total
	(dollars in millions)				
Business facilitation:					
Private equity funds .....	\$ 26	\$—	\$200	\$—	\$ 226
Real estate funds .....	378	—	—	—	378
Asset management seed capital .....	—	—	446	—	446
Industry utilities(1) .....	545	7	—	—	552
Other .....	186	38	12	10	246
Total business facilitation .....	1,135	45	658	10	1,848
Principal investments(2) .....	1,225	—	—	—	1,225
Total investments .....	<u>\$2,360</u>	<u>\$ 45</u>	<u>\$658</u>	<u>\$ 10</u>	<u>\$3,073</u>

	At November 30, 2005(3)				
	<u>Institutional Securities</u>	<u>Global Wealth Management Group</u>	<u>Asset Management</u>	<u>Discover</u>	<u>Total</u>
	(dollars in millions)				
Business facilitation:					
Private equity funds .....	\$ 14	\$—	\$185	\$—	\$ 199
Real estate funds .....	359	—	—	—	359
Asset management seed capital .....	—	—	236	—	236
Industry utilities(1) .....	371	—	—	—	371
Other .....	182	37	12	9	240
Total business facilitation .....	926	37	433	9	1,405
Principal investments .....	1,195	—	—	—	1,195
Total investments .....	<u>\$2,121</u>	<u>\$ 37</u>	<u>\$433</u>	<u>\$ 9</u>	<u>\$2,600</u>

- (1) Any investment made to participate in an industry consortium or an industry service with the intention to support core business activities and advance business growth.
- (2) Investment, dividend and net interest revenues associated with principal investments was \$239 million and \$273 million for the quarter and six month period ended May 31, 2006, respectively.
- (3) Certain reclassifications have been made to prior-period amounts to conform to the current period's presentation.

### Regulatory Requirements.

Effective December 1, 2005, the Company became a consolidated supervised entity ("CSE") as defined by the Securities and Exchange Commission ("SEC"). As such, the Company is subject to group-wide supervision and examination by the SEC and to minimum capital requirements on a consolidated basis. As of May 31, 2006, the Company was in compliance with the CSE capital requirements.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk.

#### Market Risk.

The Company uses 99%/One-Day Value-at-Risk (“VaR”) as one of a range of risk management tools. VaR values should be interpreted in light of the method’s strengths and limitations. A small proportion of risk generated by trading positions is not included in VaR, and the modeling of the risk characteristics of some positions relies upon approximations that, under certain circumstances, could produce significantly different VaR results from those produced using more precise measures. For a further discussion of the Company’s VaR methodology and its limitations, and the Company’s risk management policies and control structure, see “Quantitative and Qualitative Disclosures about Market Risk—Risk Management” in Part II, Item 7A of the Form 10-K.

The tables below present the following: the Company’s quarter-end Aggregate (Trading and Non-trading), Trading, and Non-trading VaR (see Table 1 below); the Company’s quarterly average, high, and low Trading VaR (see Table 2 below); and the VaR statistics that would result if the Company were to adopt alternative parameters for its VaR calculations, such as the reported confidence level (99% vs. 95%) for the VaR statistic or a shorter historical time series (four years vs. one year) of market data upon which it bases its simulations (see Table 3 below). Aggregate trading and non-trading VaR incorporates certain non-trading positions which are not included in Trading VaR; these include (a) the funding liabilities related to institutional trading positions and (b) public-company equity positions recorded as investments by the Company. Investments made by the Company that are not publicly traded are not reflected in the VaR results below. As of May 31, 2006, the aggregate carrying value of such investments was approximately \$2.3 billion.

The table below presents VaR for each of the Company’s primary risk exposures and on an aggregate basis at May 31, 2006, February 28, 2006 and November 30, 2005:

Table 1: 99% Total VaR	Aggregate (Trading and Non-trading)			Trading			Non-trading		
	99%/One-Day VaR at			99%/One-Day VaR at			99%/One-Day VaR at		
	May 31, 2006	February 28, 2006	November 30, 2005	May 31, 2006	February 28, 2006	November 30, 2005	May 31, 2006	February 28, 2006	November 30, 2005
	(dollars in millions)								
Primary Market Risk Category									
Interest rate and credit spread . . .	\$ 57	\$ 79	\$ 56	\$ 54	\$ 70	\$ 51	\$18	\$28	\$35
Equity price . . . . .	47	49	41	40	43	36	23	20	10
Foreign exchange rate . . . . .	12	15	10	12	15	10	—	—	—
Commodity price . . . . .	47	42	50	47	42	50	—	—	—
Subtotal . . . . .	163	185	157	153	170	147	41	48	45
Less diversification benefit(1) . . . . .	75	70	64	70	65	65	12	14	7
Total VaR . . . . .	\$ 88	\$115	\$ 93	\$ 83	\$105	\$ 82	\$29	\$34	\$38

(1) Diversification benefit equals the difference between Total VaR and the sum of the VaRs for the four risk categories. This benefit arises because the simulated one-day losses for each of the four primary market risk categories occur on different days; similar diversification benefits also are taken into account within each category.

The Company’s Aggregate VaR and Trading VaR at May 31, 2006 were \$88 million and \$83 million, respectively, compared with \$115 million and \$105 million, respectively, at February 28, 2006. At the end of the quarter ended May 31, 2006, in response to increased realized market volatility, the Company reduced its risk exposure, as measured by VaR, to a level below that which was maintained earlier in the quarter. As a result, quarter-end VaR was significantly below average Trading VaR during the quarter. The Company will continue to monitor and adjust its risk profile in consideration of future market conditions.

The Company views average Trading VaR as more representative of trends in the business over a period than VaR at any single point in time. Table 2 below, which presents the high, low and average 99%/one-day Trading VaR during the quarters ended May 31, 2006, February 28, 2006 and November 30, 2005, represents substantially all of the Company's trading activities. Certain market risks included in the Aggregate VaR discussed above are excluded from these measures (e.g., equity price risk in public company equity positions recorded as investments by the Company and certain funding liabilities related to trading positions).

Average Trading VaR for the quarter ended May 31, 2006 increased to \$96 million from \$84 million for the quarter ended February 28, 2006, reflecting increases in interest rate and credit spread VaR and equity price VaR. The increase in interest rate and credit spread VaR was driven primarily by increased exposure to credit-sensitive fixed income instruments. The increase in equity price VaR was predominantly driven by increased directional exposure to equity products.

<u>Primary Market Risk Category</u>	<u>Daily 99%/One-Day VaR for the Quarter Ended May 31, 2006</u>			<u>Daily 99%/One-Day VaR for the Quarter Ended February 28, 2006</u>			<u>Daily 99%/One-Day VaR for the Quarter Ended November 30, 2005</u>		
	<u>High</u>	<u>Low</u>	<u>Average</u>	<u>High</u>	<u>Low</u>	<u>Average</u>	<u>High</u>	<u>Low</u>	<u>Average</u>
	<b>(dollars in millions)</b>								
Interest rate and credit spread . . . . .	\$ 82	\$52	\$66	\$ 70	\$46	\$53	\$60	\$47	\$53
Equity price . . . . .	57	37	43	48	30	36	41	28	34
Foreign exchange rate . . . . .	20	8	12	22	9	14	16	10	12
Commodity price . . . . .	52	36	44	56	41	49	53	39	46
Trading VaR . . . . .	\$120	\$83	\$96	\$105	\$73	\$84	\$93	\$72	\$81

***VaR Statistics for Comparisons with Other Global Financial Services Firms.***

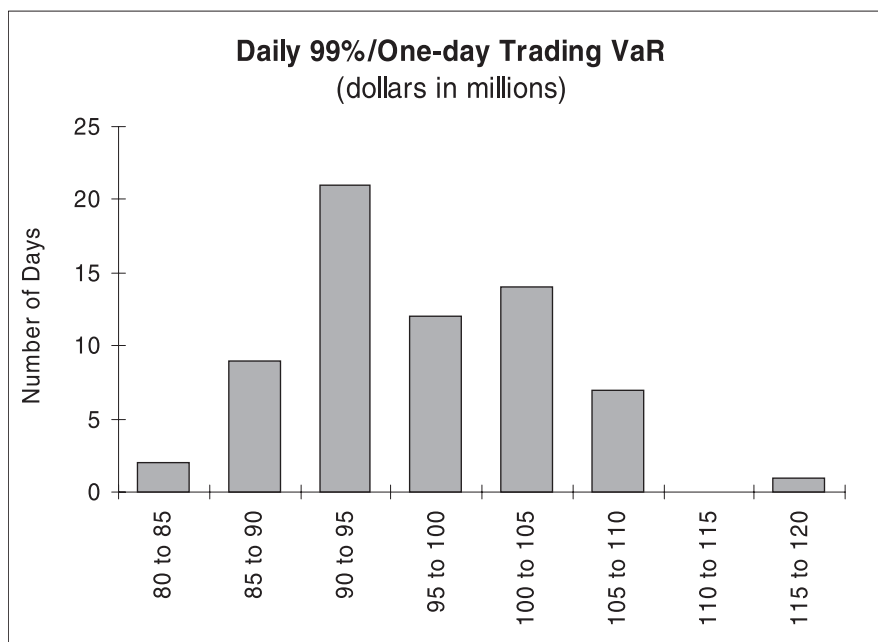
VaR statistics are not readily comparable across firms because of differences in the breadth of products included in the VaR model, in the statistical assumptions made when simulating changes in market factors, and in the methods used to approximate portfolio revaluations under the simulated market conditions. These differences can result in materially different VaR estimates for similar portfolios. As a result, VaR statistics are more reliable and relevant when used as indicators of trends in risk taking within a firm rather than as a basis for inferring differences in risk taking across firms. Table 3 below presents the VaR statistics that would result if the Company were to adopt alternative parameters for its calculations, such as the reported confidence level (99% versus 95%) for the VaR statistic or a shorter historical time series (four years versus one year), for market data upon which it bases its simulations:

<u>Primary Market Risk Category</u>	<u>Average 99%/One-Day VaR for the Quarter Ended May 31, 2006</u>		<u>Average 95%/One-Day VaR for the Quarter Ended May 31, 2006</u>	
	<u>Four-Year Factor History</u>	<u>One-Year Factor History</u>	<u>Four-Year Factor History</u>	<u>One-Year Factor History</u>
	<b>(dollars in millions)</b>			
Interest rate and credit spread . . . . .	\$66	\$48	\$39	\$32
Equity price . . . . .	43	39	29	27
Foreign exchange rate . . . . .	12	12	9	8
Commodity price . . . . .	44	64	28	32
Trading VaR . . . . .	\$96	\$88	\$63	\$58

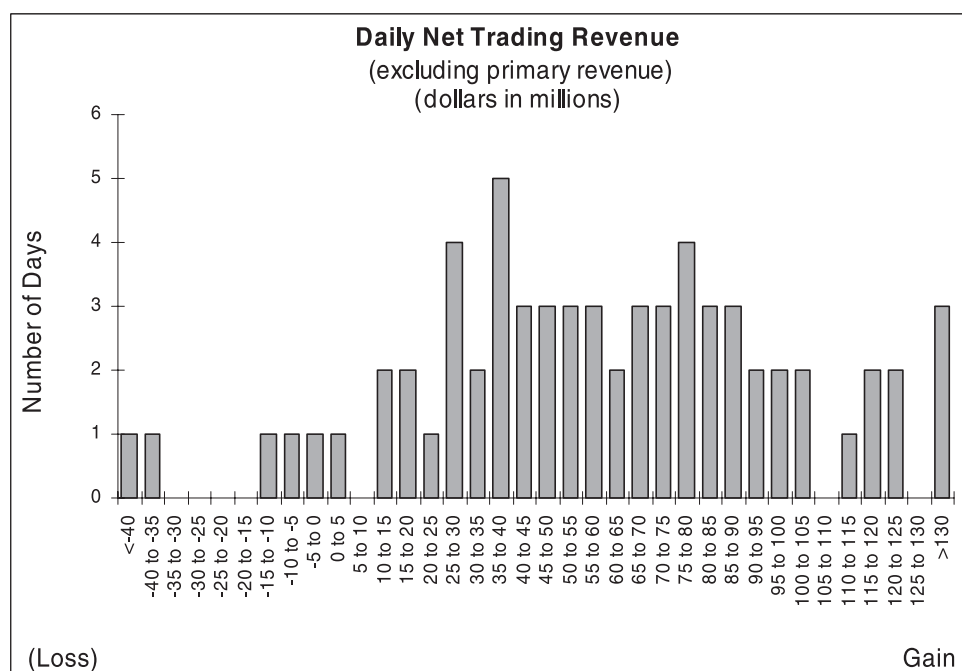
In addition, if the Company were to report Trading VaR (using a four-year historical time series) with respect to a 10-day holding period, the Company's 99% and 95% Average Trading VaR for the quarter ended May 31, 2006 would have been \$305 million and \$200 million, respectively.

***Distribution of VaR Statistics and Net Revenues for the quarter ended May 31, 2006.***

As shown in Table 2 above, the Company's average 99%/one-day Trading VaR for the quarter ended May 31, 2006 was \$96 million. The histogram below presents the distribution of the Company's daily 99%/one-day Trading VaR for the quarter ended May 31, 2006. The most frequently occurring value was between \$90 million and \$95 million.



One method of evaluating the reasonableness of the Company's VaR model as a measure of the Company's potential volatility of net revenue is to compare the VaR with actual trading revenue. Assuming no intra-day trading, for a 99%/one-day VaR, the expected number of times that trading losses should exceed VaR during the fiscal year is three, and, in general, if trading losses were to exceed VaR more than five times in a year, the accuracy of the VaR model could be questioned. Accordingly, the Company evaluates the reasonableness of its VaR model by comparing the potential declines in portfolio values generated by the model with actual trading results. The histogram below shows the distribution of daily net revenue during the quarter ended May 31, 2006 for the Company's trading businesses (including net interest and commissions but excluding primary and prime brokerage revenue credited to the trading businesses). There were no days during the quarter ended May 31, 2006 in which the Company incurred daily trading losses in excess of the 99%/one-day Trading VaR for that given day. Additionally, there were no days during the quarter where the largest one-day loss exceeded the lowest 99%/one-day Trading VaR.



As of May 31, 2006, interest rate risk exposure associated with the Company's consumer lending activities, included within Discover, as measured by the reduction in pre-tax income resulting from a hypothetical, immediate 100 basis point increase in interest rates, had not changed significantly from November 30, 2005.

## Credit Risk.

For a further discussion of the Company's credit risks, see "Quantitative and Qualitative Disclosures about Market Risks—Credit Risk" in Part II, Item 7A of the Form 10-K.

**Credit Exposure-Corporate Lending.** At May 31, 2006 and November 30, 2005, the aggregate value of investment grade loans and financial accommodations was \$6.2 billion and \$5.0 billion, respectively, and the aggregate value of non-investment grade loans and positions was \$2.9 billion and \$2.3 billion, respectively. At May 31, 2006 and November 30, 2005, the aggregate value of lending commitments outstanding was \$35.3 billion and \$37.0 billion, respectively. In connection with these business activities (which include funded corporate loans and lending commitments), the Company had hedges with a notional amount of \$23.8 billion and \$17.8 billion at May 31, 2006 and November 30, 2005, respectively, including both internal and external hedges utilized by the lending business. The table below shows the Company's credit exposure from its corporate lending positions and commitments as of May 31, 2006:

### Corporate Lending Commitments and Funded Loans

Credit Rating(1)	Years to Maturity				Total Corporate Lending Exposure(2)	Funded Corporate Loans
	Less than 1	1-3	3-5	Over 5		
	(dollars in millions)					
AAA .....	\$ 287	\$ 115	\$ 268	\$ —	\$ 670	\$ —
AA .....	2,806	1,747	2,381	552	7,486	2,783
A .....	1,285	2,624	4,520	1,393	9,822	453
BBB .....	2,805	2,489	8,771	1,216	15,281	2,935
Non-investment grade .....	3,789	1,296	2,849	3,205	11,139	2,950
Total .....	<u>\$10,972</u>	<u>\$8,271</u>	<u>\$18,789</u>	<u>\$6,366</u>	<u>\$44,398</u>	<u>\$9,121</u>
Notional amount of hedges owned .....					<u>\$23,822</u>	

(1) Obligor credit ratings are determined by Institutional Credit using methodologies generally consistent with those employed by external rating agencies.

(2) Total corporate lending exposure includes both lending commitments and funded loans.

**Credit Exposure-Derivatives.** The table below presents a summary by counterparty credit rating and remaining contract maturity of the fair value of OTC derivatives in a gain position at May 31, 2006. Fair value represents the risk reduction arising from master netting agreements, where applicable, and, in the final column, net of collateral received (principally cash and U.S. government and agency securities):

### OTC Derivative Products—Financial Instruments Owned(1)

Credit Rating(2)	Years to Maturity				Cross-Maturity and Cash Collateral Netting(3)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	Less than 1	1-3	3-5	Over 5			
	(dollars in millions)						
AAA .....	\$ 1,723	\$ 1,309	\$ 1,306	\$ 1,893	\$ (1,768)	\$ 4,463	\$ 4,225
AA .....	7,895	4,630	5,342	10,813	(15,157)	13,523	12,841
A .....	3,943	2,581	2,583	6,861	(6,729)	9,239	8,002
BBB .....	4,177	3,286	3,144	3,031	(4,743)	8,895	6,711
Non-investment grade .....	3,489	2,029	2,519	2,104	(3,643)	6,498	3,632
Unrated(4) .....	1,365	624	169	346	(301)	2,203	217
Total .....	<u>\$22,592</u>	<u>\$14,459</u>	<u>\$15,063</u>	<u>\$25,048</u>	<u>\$(32,341)</u>	<u>\$44,821</u>	<u>\$35,628</u>

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

- (2) Obligor credit ratings are determined by Institutional Credit using methodologies generally consistent with those employed by external rating agencies.
- (3) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within such maturity category, where appropriate. Cash collateral received is netted on a counterparty basis, provided legal right of offset exists.
- (4) In lieu of making an individual assessment of the creditworthiness of unrated companies, the Company makes a determination that the collateral held with respect to such obligations is sufficient to cover a substantial portion of its exposure. In making this determination, the Company takes into account various factors, including legal uncertainties and market volatility.

The following tables summarize the fair values of the Company's OTC derivative products recorded in Financial instruments owned and Financial instruments sold, not yet purchased by product category and maturity at May 31, 2006, including on a net basis, where applicable, reflecting the fair value of related non-cash collateral for financial instruments owned:

### OTC Derivative Products—Financial Instruments Owned

Product Type	Years to Maturity				Cross-Maturity and Cash Collateral Netting(1)	Net Exposure Post-Cash Collateral	Net Exposure Post- Collateral
	Less than 1	1-3	3-5	Over 5			
	(dollars in millions)						
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts . . . . .	\$ 4,030	\$ 5,897	\$ 9,454	\$22,404	\$(23,274)	\$18,511	\$15,739
Foreign exchange forward contracts and options . . . . .	7,971	605	127	18	(690)	8,031	6,493
Equity securities contracts (including equity swaps, warrants and options) . . . . .	2,795	2,031	906	256	(1,586)	4,402	2,337
Commodity forwards, options and swaps . . . . .	7,796	5,926	4,576	2,370	(6,791)	13,877	11,059
Total . . . . .	\$22,592	\$14,459	\$15,063	\$25,048	\$(32,341)	\$44,821	\$35,628

- (1) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity and product categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within the maturity category, where appropriate. Cash collateral received is netted on a counterparty basis, provided legal right of offset exists.

### OTC Derivative Products—Financial Instruments Sold, Not Yet Purchased(1)

Product Type	Years to Maturity				Cross-Maturity and Cash Collateral Netting(2)	Total
	Less than 1	1-3	3-5	Over 5		
	(dollars in millions)					
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts . . . . .	\$ 3,829	\$ 6,382	\$6,191	\$14,429	\$(19,067)	\$11,764
Foreign exchange forward contracts and options . . .	8,332	501	83	37	(901)	8,052
Equity securities contracts (including equity swaps, warrants and options) . . . . .	3,284	2,214	1,093	717	(956)	6,352
Commodity forwards, options and swaps . . . . .	8,644	7,082	2,559	1,660	(7,579)	12,366
Total . . . . .	\$24,089	\$16,179	\$9,926	\$16,843	\$(28,503)	\$38,534

- (1) Since these amounts are liabilities of the Company, they do not result in credit exposures.
- (2) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity and product categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within the maturity category, where appropriate. Cash collateral paid is netted on a counterparty basis, provided legal right of offset exists.



The Company's derivatives (both listed and OTC) at May 31, 2006 and November 30, 2005 are summarized in the table below, showing the fair value of the related assets and liabilities by product:

<u>Product Type</u>	<u>At May 31, 2006</u>		<u>At November 30, 2005</u>	
	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
	(dollars in millions)			
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts . . . . .	\$18,661	\$11,838	\$17,157	\$13,212
Foreign exchange forward contracts and options . . . . .	8,034	8,053	7,548	7,597
Equity securities contracts (including equity swaps, warrants and options) . . . . .	10,393	15,793	7,290	11,957
Commodity forwards, options and swaps . . . . .	14,448	13,063	13,899	12,186
Total . . . . .	<u>\$51,536</u>	<u>\$48,747</u>	<u>\$45,894</u>	<u>\$44,952</u>

Each category of OTC derivative products in the above tables includes a variety of instruments, which can differ substantially in their characteristics. Instruments in each category can be denominated in U.S. dollars or in one or more non-U.S. currencies.

The fair values recorded in the above tables are determined by the Company using various pricing models. For a discussion of fair value as it affects the condensed consolidated financial statements, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations—Critical Accounting Policies" in Part I, Item 2 and Note 1 to the condensed consolidated financial statements. As discussed under "Critical Accounting Policies," the structure of the transaction, including its maturity, is one of several important factors that may impact the price transparency. The impact of maturity on price transparency can differ significantly among product categories. For example, single currency and multi-currency interest rate derivative products involving highly standardized terms and the major currencies (e.g., the U.S. dollar or the euro) will generally have greater price transparency from published external sources even in maturity ranges beyond 20 years. Credit derivatives with highly standardized terms and liquid underlying reference instruments can have price transparency from published external sources in a maturity ranging up to 10 years, while equity and foreign exchange derivative products with standardized terms in major currencies can have price transparency from published external sources within a two-year maturity range. Commodity derivatives with standardized terms and delivery locations can have price transparency from published external sources within various maturity ranges up to 10 years, depending on the commodity. In most instances of limited price transparency based on published external sources, dealers in these markets, in their capacities as market-makers and liquidity providers, provide price transparency beyond the above maturity ranges.

**Country Exposure.** The Company monitors its credit exposure and risk to individual countries. Credit exposure to a country arises from the Company's lending activities and derivatives activities in a country. At May 31, 2006, less than 6% of the Company's total credit exposure (including corporate loans, lending commitments and derivative contracts) was to emerging markets, and no one emerging market country accounted for more than 1% of the Company's total credit exposure. Country credit ratings are derived using methodologies generally consistent with those employed by external rating agencies.

**Industry Exposure.** The Company also monitors its credit exposure and risk to individual industries. At May 31, 2006, the Company's material credit exposure (including corporate loans, lending commitments and derivative contracts) was to entities engaged in the following industries: financial institutions, utilities, sovereign-related entities, consumer-related, forest/metals, and energy.

#### **Item 4. Controls and Procedures**

Under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

No change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) occurred during the period covered by this report that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **Part II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

In addition to the matters described in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2005 (the "Form 10-K"), the Company's Quarterly Report on Form 10-Q for the quarterly period ended February 28, 2006 (the "First Quarter Form 10-Q") and those described below, in the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions, and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or in financial distress.

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

The Company contests liability and/or the amount of damages in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss, if any, related to such matters, how such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, fine, penalty or other relief, if any, might be. Subject to the foregoing, and except for the pending matters described in Note 8 in "Notes to Condensed Consolidated Financial Statements" in Part I, Item 1, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of the pending matters will not have a material adverse effect on the consolidated financial condition of the Company, although the outcome of such matters could be material to the Company's operating results for a particular future period, depending on, among other things, the level of the Company's revenues or income for such period.

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

#### **General American Litigation.**

On April 24, 2006, a Second Amended Petition captioned *Finke, et al. v. Morgan Stanley & Co. Incorporated, et al.*, was filed in the Missouri Circuit Court, Twenty-Second Judicial Circuit (St. Louis City), by the Director of the Department of Insurance for the State of Missouri and the Special Deputy Liquidator for General American Mutual Holding Company against Morgan Stanley & Co. Incorporated, the Company and a former officer of General American. The amended petition, which updated a petition first filed on or about July 28, 2004, asserts several causes of action against the Morgan Stanley defendants, including claims for fraud, breach of fiduciary duty, and negligent misrepresentation. The case arises out of the firm's investment banking work in connection with a potential demutualization and initial public offering of General American in 1998-1999. Fact discovery in the case is ongoing. Plaintiffs seek compensatory damages of over \$1 billion and punitive damages of over \$3 billion.

(b) The following developments have occurred with respect to certain matters previously reported in the Form 10-K and the First Quarter Form 10-Q.

#### **Coleman Litigation.**

On June 28, 2006, the District Court of Appeal for the Fourth District of Florida heard oral argument on the Company's appeal from the judgment of the trial court.

**IPO Fee Litigation.**

On April 18, 2006, in *In re Issuer Plaintiff Initial Public Offering Fee Antitrust Litigation*, the U.S. District Court for the Southern District of New York (the “SDNY”) denied plaintiffs’ motion for class certification. On May 1, 2006, plaintiffs filed a petition pursuant to Federal Rule of Civil Procedure 23(f) for leave to appeal the denial of class certification with the U.S. Court of Appeals for the Second Circuit (the “Second Circuit”).

**IPO Allocation Matters.**

On June 6, 2006, in *In re Initial Public Offering Securities Litigation*, the Second Circuit heard oral argument on defendants’ appeal of the SDNY’s grant of class certification in certain of these matters.

**Mutual Fund Sales Practices.**

On April 14, 2006, in *In re Morgan Stanley and Van Kampen Mutual Funds Securities Litigation*, the SDNY granted defendants’ motion to dismiss the consolidated amended complaint in its entirety and denied plaintiffs’ motion for leave to file a supplemental pleading. The time to notice an appeal of the Court’s rulings has expired.

**AOL Time Warner Litigation.**

In the Alaska action, the Company’s renewed motion to dismiss the plaintiffs’ amended claims under the Alaska Securities Act was granted on June 8, 2006. The only claim that remains against the Company in the Alaska action is one for negligent misrepresentation.

The numerous opt-out individual actions filed in various federal courts were transferred to the SDNY and consolidated. Plaintiffs have been filing amended complaints in these actions. On June 30, 2006, defendants filed motions to dismiss the claims common to all complaints.

**LVMH Litigation.**

On June 30, 2006, the Paris Court of Appeal (the “Appeal Court”) handed down its judgment. The Appeal Court overturned the Commercial Court’s findings in relation to the content of the Company’s research, including the finding of denigration, and overturned the Commercial Court’s award of €30 million. The Appeal Court upheld the Commercial Court’s decision on two issues, namely findings of errors in some of the Company’s disclosures and in one press interview, and appointed an expert to prepare a report on material damage suffered by LVMH Moët Hennessey Louis Vuitton as a result of those errors.

**Indonesian Litigation.**

On May 3, 2006, in the suit relating to the 1994 bond issue instituted in January 2005, the Indonesian District Court issued its judgment, declaring the bond issue to be null and void, holding that defendants (including the Company) had committed unspecified tortious acts, but awarding no damages. Defendants have appealed those decisions to the Indonesian High Court.

**Email Matters.**

On May 12, 2006, the U.S. District Court for the District of Columbia (the “D.C. District Court”) entered Final Judgment effecting a settlement the Company had reached with the SEC, the New York Stock Exchange, Inc. (“NYSE”) and the National Association of Securities Dealers, Inc. (the “NASD”) relating to Morgan Stanley & Co. Incorporated’s (“MS&Co.’s”) production of email in the research analyst and IPO investigations from December 2000 through at least July 2005. The complaint, filed by the SEC in the District Court on May 10, 2006, alleges that MS&Co. did not timely produce emails in response to requests in those matters because it did not diligently search for back-up tapes containing responsive emails until 2005, and because it over-wrote back-up tapes potentially containing responsive email until at least December 2002. Without admitting or denying the allegations of the complaint, MS&Co. consented to (1) a permanent injunction barring future violations of §17(b) of the Exchange Act (which requires, among other things, that the Company respond promptly to SEC subpoenas and requests) and the relevant regulations promulgated thereunder and (2) the payment of a \$15 million civil penalty, \$5 million of which will be paid to the NASD and the NYSE.

### **Global Wealth Management Employment Matters.**

In *Garett v. Morgan Stanley & Co., Inc., and Morgan Stanley DW Inc.*, the U.S. District Court for the Southern District of California granted preliminary approval of the parties' settlement.

Additional complaints raising wage and hour allegations against the Company have also been filed in Connecticut and New Jersey. On May 22, 2006, a purported class action, captioned *Janemarie Lenihan v. Morgan Stanley & Co., Inc. and Morgan Stanley DW Inc.*, was filed in the U.S. District Court for the District of Connecticut. On May 22, 2006, a second matter, captioned *Robert Adler et al. v. Morgan Stanley & Co., Inc. and Morgan Stanley DW Inc.*, was filed in the Superior Court of New Jersey, Law Division, Bergen County.

The Company has also been named in two purported class actions alleging gender discrimination under state and federal law. On June 22, 2006, a purported class action, captioned *Joanne Augst-Johnson et al. v. Morgan Stanley DW Inc.*, was filed in the D.C. District Court. On June 22, 2006, a second purported class action captioned *Daisy Jaffe v. Morgan Stanley DW Inc.*, was filed in the U.S. District Court for the Northern District of California. Plaintiffs seek damages in law and in equity.

### **Item 1A. Risk Factors**

See "Risk Factors" in Part I, Item 1A of the Form 10-K.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The table below sets forth the information with respect to purchases made by or on behalf of the Company of the Company's common stock during the quarterly period ended May 31, 2006.

### 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
<b>Month #1 (March 1, 2006 – March 31, 2006)</b>				
Equity Anti-dilution Program (A) . . . . .	—	\$ —	—	(A)
Capital Management Program (B) . . . . .	—	N/A	—	\$600
Employee Transactions (D) . . . . .	291,541	\$61.98	N/A	N/A
<b>Month #2 (April 1, 2006 – April 30, 2006)</b>				
Equity Anti-dilution Program (A) . . . . .	285,900	\$63.98	285,900	(A)
Capital Management Program (B) . . . . .	—	N/A	—	\$600
Employee Transactions (D) . . . . .	159,671	\$64.32	N/A	N/A
<b>Month #3 (May 1, 2006 – May 31, 2006)</b>				
Equity Anti-dilution Program (A) . . . . .	1,480,598	\$63.95	1,480,598	(A)
Capital Management Program (B) . . . . .	—	N/A	—	\$600
Employee Transactions (D) . . . . .	311,536	\$59.12	N/A	N/A
<b>Total</b>				
Equity Anti-dilution Program (A) . . . . .	1,766,498	\$63.96	1,766,498	(A)
Capital Management Program (B) . . . . .	—	N/A	—	\$600
Employee Transactions (D) . . . . .	762,748	\$61.31	N/A	N/A

- (A) The Company's board of directors authorized this program to purchase common stock to offset the dilutive impact of grants and exercises of awards under the Company's equity-based compensation and benefit plans. The program was publicly announced on January 7, 1999 and has no set expiration or termination date. There is no maximum amount of shares that may be purchased under the program.
- (B) The Company's board of directors authorized this program to purchase common stock for capital management purposes. The program was publicly announced on February 12, 1998 at which time up to \$3 billion of stock was authorized to be purchased. The program was subsequently increased by \$1 billion on December 18, 1998, \$1 billion on December 20, 1999 and \$1.5 billion on June 20, 2000. This program has a remaining capacity of \$600 million at May 31, 2006 and has no set expiration or termination date.
- (C) Share purchases under publicly announced programs are made pursuant to open-market purchases, Rule 10b5-1 plans or privately negotiated transactions (including with employee benefit plans) as market conditions warrant and at prices the Company deems appropriate.
- (D) Includes: (1) shares delivered or attested to in satisfaction of the exercise price and/or tax withholding obligations by holders of employee stock options (granted under employee stock compensation plans) who exercised options; (2) restricted shares withheld (under the terms of grants under employee stock compensation plans) to offset tax withholding obligations that occur upon vesting and release of restricted shares; and (3) shares withheld (under the terms of grants under employee stock compensation plans) to offset tax withholding obligations that occur upon the delivery of outstanding shares underlying restricted stock units. The Company's employee stock compensation plans provide that the value of the shares delivered or attested, or withheld, shall be the average of the high and low price of the Company's common stock on the date the relevant transaction occurs.

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

Information regarding the submission of matters to a vote of security holders under Item 8.01 of the Company's Current Report on Form 8-K filed on April 4, 2006 is incorporated by reference herein.

## Item 6. Exhibits

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

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MORGAN STANLEY

(Registrant)

By: \_\_\_\_\_ /s/ DAVID H. SIDWELL

David H. Sidwell,  
Chief Financial Officer

By: \_\_\_\_\_ /s/ PAUL C. WIRTH

Paul C. Wirth,  
Controller and Principal Accounting Officer

Date: July 7, 2006

**EXHIBIT INDEX**  
**MORGAN STANLEY**  
**Quarter Ended May 31, 2006**

<u>Exhibit No.</u>	<u>Description</u>
3.1 and 4.1	Certificate of Designation (Exhibit 3.1 and 4.1 to the Company's Current Report on Form 8-K dated July 5, 2006).
3.2	Amended and Restated Bylaws, as amended to date (Exhibit 3 to the Company's Current Report on Form 8-K dated June 20, 2006).
4.2	Certificate representing the Series A Preferred Stock.
4.3	Deposit Agreement dated as of July 6, 2006 among the Company, JPMorgan Chase Bank, N.A. and the holders from time to time of the depositary receipts described therein.
4.4	Depositary Receipt for Depositary Shares, representing Floating Rate Non-Cumulative Preferred Stock, Series A (included in Exhibit 4.3 hereto).
10.1	Tax Deferred Equity Participation Plan, amended and restated as of June 20, 2006.
10.2	Morgan Stanley Financial Advisor Productivity Compensation Plan, amended and restated as of June 20, 2006.
10.3	Morgan Stanley Performance Formula and Provisions.
10.4	Morgan Stanley Schedule of Non-Employee Directors Retainers, effective July 6, 2006 (Exhibit 10 to the Company's Current Report on Form 8-K dated June 20, 2006).
11	Statement Re: Computation of Earnings Per Common Share (The calculation of per share earnings is in Part I, Item 1, Note 7 to the Condensed Consolidated Financial Statements (Earnings per Share) and is omitted in accordance with Section (b)(11) of Item 601 of Regulation S-K).
12	Statement Re: Computation of Ratio of Earnings to Fixed Charges and Computation of Earnings to Fixed Charges and Preferred Stock Dividends.
15	Letter of awareness from Deloitte & Touche LLP, dated July 6, 2006, concerning unaudited interim financial information.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.



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