Item 8. Financial Statements and Supplementary Data.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
Morgan Stanley:

We have audited the accompanying consolidated statements of financial condition of Morgan Stanley and subsidiaries (the "Company") as of fiscal years ended November 30, 2002 and 2001, and the related consolidated statements of income, comprehensive income, cash flows and changes in shareholders' equity for each of the three fiscal years in the period ended November 30, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of Morgan Stanley and subsidiaries at fiscal years ended November 30, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three fiscal years in the period ended November 30, 2002, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

New York, New York
January 10, 2003

MORGAN STANLEY

Consolidated Statements of Financial Condition
(dollars in millions, except share data)

	November 30, 2002	November 30, 2001
Assets		
Cash and cash equivalents	$ 29,212	$ 26,596
Cash and securities deposited with clearing organizations or segregated under federal and other regulations (including securities at fair value of $27,721 at November 30, 2002 and $36,146 at November 30, 2001)	38,411	46,326
Financial instruments owned (approximately $71 billion and $74 billion were pledged to various parties at November 30, 2002 and November 30, 2001, respectively):		
U.S. government and agency securities	32,474	25,696
Other sovereign government obligations	27,694	22,039
Corporate and other debt	55,254	47,607
Corporate equities	21,996	23,143
Derivative contracts	35,615	32,078
Physical commodities	355	285
Securities purchased under agreements to resell	76,910	54,618
Securities received as collateral	12,200	13,163
Securities borrowed	130,404	120,758
Receivables:		
Consumer loans (net of allowances of $928 at November 30, 2002 and $847 at November 30, 2001)	23,404	20,108
Customers, net	22,262	22,188
Brokers, dealers and clearing organizations	2,250	6,462
Fees, interest and other	4,892	5,283
Office facilities, at cost (less accumulated depreciation of $2,206 at November 30, 2002 and $2,124 at November 30, 2001)	2,270	2,579
Aircraft under operating leases (less accumulated depreciation of $769 at November 30, 2002 and $479 at November 30, 2001)	4,849	4,753
Goodwill	1,449	1,438
Other assets	7,598	7,508
Total assets	$529,499	$482,628

MORGAN STANLEY

Consolidated Statements of Financial Condition—(Continued)
(dollars in millions, except share data)

	November 30, 2002	November 30, 2001
Liabilities and Shareholders' Equity		
Commercial paper and other short-term borrowings	$ 50,789	$ 32,842
Deposits	13,757	12,276
Financial instruments sold, not yet purchased:		
U.S. government and agency securities	13,235	17,203
Other sovereign government obligations	11,679	10,906
Corporate and other debt	12,240	9,125
Corporate equities	18,320	13,046
Derivative contracts	28,985	27,286
Physical commodities	1,833	2,044
Securities sold under agreements to repurchase	136,463	122,695
Obligation to return securities received as collateral	12,200	13,163
Securities loaned	43,229	36,776
Payables:		
Customers	88,229	93,719
Brokers, dealers and clearing organizations	4,610	4,331
Interest and dividends	3,363	2,761
Other liabilities and accrued expenses	12,245	12,795
Long-term borrowings	55,161	49,668
	506,338	460,636
Capital Units	66	66
Preferred securities subject to mandatory redemption	1,210	1,210
Commitments and contingencies		
Shareholders' equity:		
Preferred stock	—	345
Common stock ($0.01 par value, 3,500,000,000 shares authorized, 1,211,685,904 and 1,211,685,904 shares issued, 1,081,417,377 and 1,093,006,744 shares outstanding at November 30, 2002 and November 30, 2001, respectively)	12	12
Paid-in capital	3,678	3,745
Retained earnings	25,250	23,270
Employee stock trust	3,003	3,086
Accumulated other comprehensive income (loss)	(251)	(262)
Subtotal	31,692	30,196
Note receivable related to ESOP	(13)	(31)
Common stock held in treasury, at cost ($0.01 par value, 130,268,527 and 118,679,160 shares at November 30, 2002 and November 30, 2001, respectively)	(7,176)	(6,935)
Common stock issued to employee trust	(2,618)	(2,514)
Total shareholders' equity	21,885	20,716
Total liabilities and shareholders' equity	$529,499	$482,628

See Notes to Consolidated Financial Statements.

MORGAN STANLEY

Consolidated Statements of Income
(dollars in millions, except share and per share data)

	Fiscal Year		
	2002	2001	2000
Revenues:			
Investment banking	$ 2,527	$ 3,425	$ 5,008
Principal transactions:			
Trading	2,685	5,491	7,361
Investments	(35)	(316)	193
Commissions	3,280	3,162	3,647
Fees:			
Asset management, distribution and administration	3,945	4,216	4,405
Merchant and cardmember	1,420	1,349	1,256
Servicing	2,091	1,904	1,489
Interest and dividends	15,866	24,127	21,234
Other	636	516	513
Total revenues	32,415	43,874	45,106
Interest expense	11,970	20,729	18,148
Provision for consumer loan losses	1,336	1,052	810
Net revenues	19,109	22,093	26,148
Non-interest expenses:			
Compensation and benefits	7,933	9,372	10,896
Occupancy and equipment	825	881	755
Brokerage, clearing and exchange fees	775	700	600
Information processing and communications	1,379	1,460	1,317
Marketing and business development	1,133	1,277	1,582
Professional services	1,094	1,299	1,278
Other	1,015	1,370	1,201
Restructuring and other charges	235	—	—
Total non-interest expenses	14,389	16,359	17,629
Gain on sale of business	—	—	35
Income before income taxes, dividends on preferred securities subject to mandatory redemption, extraordinary item and cumulative effect of accounting change	4,720	5,734	8,554
Provision for income taxes	1,645	2,074	3,070
Dividends on preferred securities subject to mandatory redemption	87	50	28
Income before extraordinary item and cumulative effect of accounting change	2,988	3,610	5,456
Extraordinary item	—	(30)	—
Cumulative effect of accounting change	—	(59)	—
Net income	$ 2,988	$ 3,521	$ 5,456
Preferred stock dividend requirements	$ —	$ 32	$ 36
Earnings applicable to common shares	$ 2,988	$ 3,489	$ 5,420
Earnings per common share:			
Basic before extraordinary item and cumulative effect of accounting change	$ 2.76	$ 3.29	$ 4.95
Extraordinary item	—	(0.03)	—
Cumulative effect of accounting change	—	(0.05)	—
Basic	$ 2.76	$ 3.21	$ 4.95
Diluted before extraordinary item and cumulative effect of accounting change	$ 2.69	$ 3.19	$ 4.73
Extraordinary item	—	(0.03)	—
Cumulative effect of accounting change	—	(0.05)	—
Diluted	$ 2.69	$ 3.11	$ 4.73
Average common shares outstanding:			
Basic	1,083,270,783	1,086,121,508	1,095,858,438
Diluted	1,109,637,953	1,121,764,086	1,145,011,515

See Notes to Consolidated Financial Statements.

MORGAN STANLEY

Consolidated Statements of Comprehensive Income
(dollars in millions)

	Fiscal Year		
	2002	**2001**	**2000**
Net income	$2,988	$3,521	$5,456
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustment	30	(59)	(64)
Cumulative effect of accounting change	—	(13)	—
Net change in cash flow hedges	—	(99)	—
Minimum pension liability adjustment	(19)	—	—
Comprehensive income	$2,999	$3,350	$5,392

See Notes to Consolidated Financial Statements.

MORGAN STANLEY

Consolidated Statements of Cash Flows
(dollars in millions)

	Fiscal Year		
	2002	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 2,988	$ 3,521	$ 5,456
Adjustments to reconcile net income to net cash used for operating activities:			
Non-cash charges (credits) included in net income:			
Cumulative effect of accounting change	—	59	—
Asset impairment charge	74	87	—
Gain on sale of business	—	—	(35)
Gain on sale of building	(73)	—	—
Gain on sale of self-directed online brokerage accounts	(52)	—	—
Deferred income taxes	55	(427)	(219)
Compensation payable in common or preferred stock	388	653	908
Depreciation and amortization	787	729	727
Provision for consumer loan losses	1,336	1,052	810
Restructuring and other charges	235	—	—
Changes in assets and liabilities:			
Cash and securities deposited with clearing organizations or segregated under federal and other regulations	7,915	2,311	(38,924)
Financial instruments owned, net of financial instruments sold, not yet purchased	(15,380)	(16,288)	(10,524)
Securities borrowed, net of securities loaned	(3,193)	(13,962)	(15,036)
Receivables and other assets	5,280	(2,519)	2,078
Payables and other liabilities	(5,414)	693	52,376
Net cash used for operating activities	(5,054)	(24,091)	(2,383)
CASH FLOWS FROM INVESTING ACTIVITIES			
Net (payments for) proceeds from:			
Office facilities and aircraft under operating leases	(1,124)	(1,998)	(896)
Purchase of Quilter Holdings Limited, net of cash acquired	—	(183)	—
Purchase of Ansett Worldwide Aviation Services, net of cash acquired	—	—	(199)
Net principal disbursed on consumer loans	(8,677)	(7,053)	(11,885)
Sale of self-directed online brokerage accounts	98	—	—
Sales of consumer loans	4,048	7,638	10,294
Sale of office building	—	709	—
Net cash used for investing activities	(5,655)	(887)	(2,686)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net proceeds from (payments for) short-term borrowings	17,947	5,088	(10,563)
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell	(8,524)	21,839	12,154
Net proceeds from:			
Deposits	1,481	346	1,533
Issuance of common stock	179	197	338
Issuance of put options	6	5	42
Issuance of long-term borrowings	11,043	18,498	22,475
Issuance of preferred securities subject to mandatory redemption	—	810	—
Payments for:			
Repayments of long-term borrowings	(6,472)	(11,201)	(9,351)
Redemption of cumulative preferred stock	(345)	(200)	—
Redemption of Capital Units	—	(4)	(513)
Repurchases of common stock	(990)	(1,583)	(3,628)
Cash dividends	(1,000)	(1,040)	(924)
Net cash provided by financing activities	13,325	32,755	11,563
Net increase in cash and cash equivalents	2,616	7,777	6,494
Cash and cash equivalents, at beginning of period	26,596	18,819	12,325
Cash and cash equivalents, at end of period	$ 29,212	$ 26,596	$ 18,819

See Notes to Consolidated Financial Statements.

MORGAN STANLEY

Consolidated Statements of Changes in Shareholders' Equity
(dollars in millions)

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Employee Stock Trust	Accumulated Other Comprehensive Income (Loss)	Note Receivable Related to ESOP	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Trust	Total
BALANCE AT NOVEMBER 30, 1999	$ 670	$ 12	$3,836	$16,285	$2,426	$ (27)	$(55)	$(4,355)	$(1,778)	$17,014
Net income	—	—	—	5,456	—	—	—	—	—	5,456
Dividends	—	—	—	(939)	—	—	—	—	—	(939)
Conversion of ESOP Preferred Stock	(125)	—	(817)	—	—	—	—	942	—	—
Issuance of common stock	—	—	(446)	—	—	—	—	784	—	338
Issuance of put options	—	—	42	—	—	—	—	—	—	42
Exercise of put options	—	—	(4)	—	—	—	—	4	—	—
Repurchases of common stock	—	—	—	—	—	—	—	(3,628)	—	(3,628)
Compensation payable in common stock	—	—	766	—	616	—	—	229	(570)	1,041
ESOP shares allocated, at cost	—	—	—	—	—	—	11	—	—	11
Translation adjustments	—	—	—	—	—	(64)	—	—	—	(64)
BALANCE AT NOVEMBER 30, 2000	545	12	3,377	20,802	3,042	(91)	(44)	(6,024)	(2,348)	19,271
Net income	—	—	—	3,521	—	—	—	—	—	3,521
Dividends	—	—	—	(1,053)	—	—	—	—	—	(1,053)
Redemption of 7-¾% Cumulative Preferred Stock	(200)	—	—	—	—	—	—	—	—	(200)
ESOP shares allocated, at cost	—	—	—	—	—	—	13	—	—	13
Issuance of common stock	—	—	(364)	—	—	—	—	561	—	197
Issuance of put options	—	—	5	—	—	—	—	—	—	5
Exercise of put options	—	—	(12)	—	—	—	—	12	—	—
Repurchases of common stock	—	—	—	—	—	—	—	(1,583)	—	(1,583)
Compensation payable in common stock	—	—	739	—	44	—	—	99	(166)	716
Cumulative effect of accounting change and net change in cash flow hedges	—	—	—	—	—	(112)	—	—	—	(112)
Translation adjustments	—	—	—	—	—	(59)	—	—	—	(59)
BALANCE AT NOVEMBER 30, 2001	345	12	3,745	23,270	3,086	(262)	(31)	(6,935)	(2,514)	20,716
Net income	—	—	—	2,988	—	—	—	—	—	2,988
Dividends	—	—	—	(1,008)	—	—	—	—	—	(1,008)
Redemption of Cumulative Preferred Stock	(345)	—	—	—	—	—	—	—	—	(345)
Issuance of common stock	—	—	(350)	—	—	—	—	529	—	179
Issuance of put options	—	—	6	—	—	—	—	—	—	6
Exercise of put options	—	—	(5)	—	—	—	—	5	—	—
Repurchases of common stock	—	—	—	—	—	—	—	(990)	—	(990)
Compensation payable in common stock	—	—	282	—	(83)	—	—	215	(104)	310
ESOP shares allocated, at cost	—	—	—	—	—	—	18	—	—	18
Minimum pension liability adjustment	—	—	—	—	—	(19)	—	—	—	(19)
Translation adjustments	—	—	—	—	—	30	—	—	—	30
BALANCE AT NOVEMBER 30, 2002	$ —	$ 12	$3,678	$25,250	$3,003	$(251)	$(13)	$(7,176)	$(2,618)	$21,885

See Notes to Consolidated Financial Statements.

MORGAN STANLEY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Introduction and Basis of Presentation.

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

In fiscal 2002, the Company's name changed from "Morgan Stanley Dean Witter & Co." to "Morgan Stanley."

Basis of Financial Information. The consolidated financial statements for the 12 months ended November 30, 2002 ("fiscal 2002"), November 30, 2001 ("fiscal 2001") and November 30, 2000 ("fiscal 2000") 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 potential outcome of litigation, and other matters that affect the consolidated financial statements and related disclosures. The Company believes that the estimates utilized in the preparation of the consolidated financial statements are prudent and reasonable. Actual results could differ materially from these estimates.

The 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 subsidiaries in which it owns more than 50% of the outstanding voting stock unless it does not control the subsidiary. For investments in companies in which the Company has significant influence over operating and financial decisions (generally defined as owning a voting or economic interest of 20% to 50%), the Company applies the equity method of accounting. In those cases where the Company's investment is less than 20% and significant influence does not exist, such investments are carried at cost.

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

Certain reclassifications have been made to prior-year amounts to conform to the current presentation. All material intercompany balances and transactions have been eliminated.

2. Summary of Significant Accounting Policies.

Consolidated Statements of Cash Flows. For purposes of these statements, cash and cash equivalents consist of cash and highly liquid investments not held for resale with maturities, when purchased, of three months or less.

In connection with the fiscal 2001 purchase of Quilter Holdings Limited ("Quilter"), the Company issued approximately $37 million of notes payable, including approximately $13 million of notes that are convertible into common shares of the Company.

In connection with the fiscal 2000 purchase of Ansett Worldwide Aviation Services ("Ansett Worldwide"), the Company assumed $1,380 million of long-term borrowings.

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. Interest on consumer loans is credited to income as earned.

Interest is 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 bankruptcies and fraudulent transactions, which are charged off earlier. 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.

Allowance for Consumer Loan Losses. The allowance for consumer loan losses is a significant estimate that represents management's estimate of probable losses inherent in the consumer loan portfolio. The allowance for consumer loan losses is an allowance applicable to the owned homogeneous consumer credit card loan portfolio that is evaluated quarterly for adequacy and is established through a charge to the provision for consumer loan losses.

In calculating the allowance for consumer loan losses, the Company uses a systematic and consistently applied approach. The amount of the allowance is established through a process that begins with estimates of the losses inherent in the consumer loan portfolio based on coverage of a rolling average of historical credit losses. In addition, the Company regularly performs a migration analysis (a technique used to estimate the likelihood that a consumer loan will progress through the various stages of delinquency and ultimately charge-off) of delinquent and current consumer credit card accounts in order to determine the appropriate level of the allowance for consumer loan losses. The migration analysis considers uncollectible principal, interest and fees reflected in consumer loans. In evaluating the adequacy of the allowance for consumer loan losses, management also considers factors that may impact future credit loss experience, including current economic conditions, recent trends in delinquencies and bankruptcy filings, account 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.

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 consolidated statements of financial condition, and gains and losses are reflected in principal trading revenues in the consolidated statements of income. Loans and lending commitments associated with the Company's lending activities also are recorded at fair value. Fair value is the amount at which financial instruments could be exchanged in a current transaction between willing parties, other than in a forced or distressed sale.

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

A substantial percentage of the fair value of the Company's financial instruments owned and financial instruments sold, not yet purchased, is based on observable market prices, observable market parameters, or is derived from such prices or parameters. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing parameters in a product (or a related product) may be used to derive a price without requiring significant judgment. In certain markets, observable market prices or market parameters are not available for all products, and fair value is determined using techniques appropriate for each particular product. These analyses may involve a degree of judgment.

The fair value of over-the-counter ("OTC") derivative contracts is derived from pricing models, which may require multiple market input parameters. The Company relies on pricing models as a valuation methodology to determine fair value for OTC derivative products because market convention is to quote input parameters to models rather than prices, not because of a lack of an active trading market. The term "model" typically refers to a mathematical calculation methodology based on accepted financial theories. Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed form analytic formulae, such as the Black-Scholes option pricing model, simulation models or a combination thereof, applied consistently. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. Pricing models take into account the contract terms, including the maturity, as well as quoted market parameters such as interest rates, volatility and the creditworthiness of the counterparty.

Interest and dividend revenue and interest expense arising from financial instruments used in trading activities are reflected in the consolidated statements of income as interest and dividend revenue or interest expense. Purchases and sales of financial instruments as well as commission revenues and related expenses are recorded in the accounts on trade date. Unrealized gains and losses arising from the Company's dealings in OTC financial instruments, including derivative contracts related to financial instruments and commodities, are presented in the accompanying consolidated statements of financial condition on a net-by-counterparty basis, when appropriate.

Equity securities purchased in connection with private equity and other principal investment activities initially are carried in the consolidated financial statements at their original costs, which approximate fair value. The carrying value of such equity securities is adjusted when changes in the underlying fair values are readily ascertainable, generally as evidenced by observable market prices or transactions that directly affect the value of such equity securities. Downward adjustments relating to such equity securities are made in the event that the Company determines that the eventual realizable value is less than the carrying value. The Company's partnership interests, including general partnership and limited partnership interests in real estate funds, are included within Other assets in the Company's 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 consolidated statements of financial condition and include interest rate swaps, foreign currency swaps, equity swaps and foreign exchange forwards. The Company uses interest rate and currency swaps and equity derivatives to manage interest rate, currency and equity price risk arising from certain borrowings. The Company also utilizes interest rate swaps to match the repricing characteristics of consumer loans with those of the borrowings that fund these loans. Certain of these derivative financial instruments are designated and qualify as fair value hedges and cash flow hedges in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended.

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

For qualifying fair value hedges, the changes in the fair value of the derivative and the gain or loss on the hedged asset or liability relating to the risk being hedged are recorded currently in earnings. These amounts are recorded in interest expense and provide offset of one another. For qualifying cash flow hedges, the changes in the fair value of the derivative are recorded in Accumulated other comprehensive income in shareholder's equity, net of tax effects, and amounts in Accumulated other comprehensive income are reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The Company estimates that approximately $56 million of the unrealized loss recognized in Accumulated other comprehensive income as of November 30, 2002 will be reclassified into earnings within the next 12 months. Ineffectiveness relating to fair value and cash flow hedges, if any, is recorded within interest expense. The impact of hedge ineffectiveness on the Company's consolidated statements of income was not material for all periods presented.

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

In fiscal 2001, the Company recorded an after-tax charge to net income from the cumulative effect of the adoption of SFAS No. 133, as amended, of $59 million and an after-tax decrease to Accumulated other comprehensive income of $13 million. The Company's adoption of SFAS No. 133, as amended, affects the accounting for, among other things, the Company's hedging strategies, including those associated with certain financing activities.

Office Facilities. Office facilities are stated at cost less accumulated depreciation and amortization. Depreciation and amortization of buildings, leasehold improvements, furniture, fixtures and equipment are provided principally by the straight-line method over the estimated useful life of the asset. Estimates of useful lives are as follows: buildings—39 years; furniture and fixtures—7 years; and computer and communications equipment—3 to 5 years. Leasehold improvements are amortized over the lesser of the estimated useful life of the asset or, where applicable, the remaining term of the lease, but generally not exceeding 15 years.

Aircraft under Operating Leases. Aircraft under operating leases are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful life of the aircraft asset, which is generally 25 years from the date of manufacture. In accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," the Company's aircraft are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the aircraft may not be recoverable. In the fourth quarter of fiscal 2001 and the third quarter of fiscal 2002, the Company recognized impairment charges pursuant to SFAS No. 121 (see Note 19).

Revenue from aircraft under operating leases is recognized on a straight-line basis over the lease term. Certain lease contracts may require the lessee to make separate payments for flight hours and passenger miles flown. In such instances, the Company recognizes these other revenues as they are earned in accordance with the terms of the applicable lease contract.

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 to match revenue recognition.

Income Taxes. Income tax expense is provided for using the asset and liability method, under which deferred tax assets and liabilities are determined based upon the temporary differences between the financial statement and income tax bases of assets and liabilities, using currently enacted tax rates.

Earnings per Share. The Company calculates earnings per share ("EPS") in accordance with SFAS No. 128, "Earnings per Share." The calculations of earnings per share are based on the weighted average number of common shares and share equivalents outstanding and give effect to preferred stock dividend requirements.

"Basic EPS" reflects no dilution from common stock equivalents, and "diluted EPS" reflects dilution from common stock equivalents and other dilutive securities based on the average price per share of the Company's common stock during the period.

Cardmember Rewards. Cardmember rewards, primarily the Cashback Bonus® award, pursuant to which the Company pays Discover Classic Card, Discover Platinum Card and Morgan Stanley Platinum Card cardmembers a percentage of their purchase amounts ranging up to 1% 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 accordance with Emerging Issues Task Force ("EITF") Issue No. 00-22, "Accounting for 'Points' and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future," the Company records its Cashback Bonus award program as a reduction of Merchant and cardmember fees.

Stock-Based Compensation. SFAS No. 123, "Accounting for Stock-Based Compensation" encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company currently accounts for its stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Under the provisions of APB No. 25, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's common stock at the date of grant over the amount an employee must pay to acquire the stock. In August 2002, the Company announced that beginning in fiscal 2003, it will expense employee stock options in accordance with SFAS No. 123 (see "New Accounting Pronouncements" herein).

Translation of Foreign Currencies. Assets and liabilities of operations having non-U.S. dollar functional currencies are translated at year-end rates of exchange, and income statement accounts are translated at weighted average rates of exchange for the year. In accordance with SFAS No. 52, "Foreign Currency Translation," gains or losses resulting from translating foreign currency financial statements, net of hedge gains or losses and related tax effects, are reflected in Accumulated other comprehensive income (loss), a separate component of shareholders' equity. Gains or losses resulting from foreign currency transactions are included in net income.

Goodwill. Prior to the Company's adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," on December 1, 2001, goodwill was amortized on a straight-line basis over periods from five to 40 years but generally not exceeding 25 years. At November 30, 2002 and November 30, 2001, goodwill of approximately $1.4 billion was included in the Company's consolidated statements of financial condition (see Note 3).

Deferred Compensation Arrangements. In accordance with EITF Issue No. 97-14, "Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested," assets of rabbi trusts are to be consolidated with those of the employer, and the value of the employer's stock held in rabbi trusts should be classified in shareholders' equity and generally accounted for in a manner similar to treasury stock. The Company, therefore, has included its obligations under certain deferred compensation plans in Employee stock trust. Shares that the Company has issued to its rabbi trusts are recorded in Common stock issued to employee trust. Both Employee stock trust and Common stock issued to employee trust are components of shareholders' equity. The Company recognizes the original amount of deferred compensation (fair value of the restricted stock unit award at the date of grant — see Note 14) as the basis for recognition in Employee stock trust and Common stock issued to employee trust. Consistent with EITF Issue No. 97-14, changes in the fair value of amounts owed to employees are not recognized as the Company's deferred compensation plans do not permit diversification and must be settled by the delivery of a fixed number of shares of the Company's common stock. The amount recorded in Employee stock trust is only higher than the amount in Common stock issued to employee trust at fiscal year-end because the transfer of the shares to the rabbi trusts occurs subsequent to fiscal year-end, whereas compensation expense relating to these shares is recorded at fiscal year-end.

Software Costs. In accordance with American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," certain costs incurred in connection with internal-use software projects are capitalized and amortized over the expected useful life of the asset.

Securitization Activities. The Company engages in securitization activities related to commercial and residential mortgage loans, corporate bonds and loans, U.S. agency collateralized mortgage obligations, municipal bonds, credit card loans and other types of financial assets (see Notes 4 and 5). The Company may retain interests in the securitized financial assets as one or more tranches of the securitization, an undivided seller's interest, accrued interest receivable subordinate to investors' interests (see Note 5), cash collateral accounts, servicing rights, and rights to any excess cash flows remaining after payments to investors in the securitization trusts of their contractual rate of return and reimbursement of credit losses. The exposure to credit losses from securitized loans is limited to the Company's retained contingent risk, which represents the Company's retained interest in securitized loans, including any credit enhancement provided. The gain or loss on the sale of financial assets depends in part on the previous carrying amount of the assets involved in the transfer, and each subsequent transfer in revolving structures, allocated between the assets sold and the retained interests based upon their respective fair values at the date of sale. To obtain fair values, observable market prices are used if available. However, observable market prices are generally not available for retained interests, so the Company estimates fair value based on the present value of expected future cash flows using its best estimates of the key assumptions, including forecasted credit losses, payment rates, forward yield curves and discount rates commensurate with the risks involved. The present value of future net servicing revenues that the Company estimates it will receive over the term of the securitized loans is recognized in income as the loans are securitized. A corresponding asset also is recorded and then amortized as a charge to income over the term of the securitized loans, with actual net servicing revenues continuing to be recognized in income as they are earned.

New Accounting Pronouncements. In August 2002, the Company announced that beginning in fiscal 2003 it will expense employee stock options in accordance with SFAS No. 123. Under the fair value-based method of SFAS No. 123, compensation expense is recognized based on the fair value of stock options on the date of grant. In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure, an amendment of FASB Statement No. 123."

SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based compensation. In addition, SFAS No. 148 requires, on an annual basis, disclosures about the method of accounting for stock-based compensation and tabular information about the effect of the method of accounting for stock-based compensation on net income and earnings per share, including pro forma amounts, in the "Summary of Significant Accounting Policies." On a quarterly basis, SFAS No. 148 requires prominent disclosure in tabular form of the effect of the method of stock-based compensation on net income and earnings per share for all periods presented if awards of stock-based compensation were outstanding and accounted for under APB Opinion No. 25. Pursuant to its announcement to begin expensing stock options in fiscal 2003, the Company adopted SFAS No. 148 on December 1, 2002 and has elected the prospective method of transition to the fair value-based method of accounting for stock-based compensation. The Company is in the process of evaluating the impact of adopting the fair value-based method of accounting and the recognition provisions of the prospective method of transition for stock-based employee compensation plans.

In November 2002, the FASB issued FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 identifies characteristics of certain guarantee contracts and requires that a liability be recognized at fair value at the inception of such guarantees for the obligations undertaken by the guarantor. Additional disclosures also are prescribed for certain guarantee contracts. The initial recognition and initial measurement provisions of FIN 45 are effective for these guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 are effective for the Company for its quarter ending February 28, 2003. The Company currently is evaluating the impact of FIN 45 on its consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities". FIN 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties ("variable interest entities"). Variable interest entities ("VIEs") are required to be consolidated by their primary beneficiaries if they do not effectively disperse risks among parties involved. The primary beneficiary of a VIE is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests. FIN 46 also requires new disclosures about VIEs.

On February 1, 2003, the Company adopted FIN 46 for VIEs created after January 31, 2003 and for VIEs in which the Company obtains an interest after January 31, 2003. The Company will adopt FIN 46 on September 1, 2003 for VIEs in which it holds a variable interest that it acquired before February 1, 2003. The Company is currently evaluating the impact of the provisions of FIN 46 on its consolidated financial statements. The Company is involved with various entities in the normal course of business that may be deemed to be VIEs and may hold interests therein, including interest-only strip investments and derivative instruments, that may be considered variable interests. Transactions associated with these entities include asset- and mortgage-backed securitizations and structured financings (including collateralized debt, bond or loan obligations and credit-linked notes). The Company principally engages in these transactions to facilitate client needs and as a means of selling financial assets. The Company currently consolidates entities in which it has a controlling financial interest in accordance with accounting principles generally accepted in the U.S. For those entities deemed to be qualifying special purpose entities (as defined in SFAS No. 140), which includes the credit card asset securitization master trust (see Note 5), the Company does not consolidate the entity.

The Company believes that it is reasonably possible that it will either disclose information in its Form 10-K for fiscal 2003 about certain VIEs created before February 1, 2003 for which it holds a significant variable interest or it will be the primary beneficiary of the entity and thus be required to consolidate the VIE on September 1, 2003.

At November 30, 2002, in connection with its institutional securities business, the aggregate size of the entities for which the Company's interest is either significant or for which the Company could be deemed to be the primary beneficiary of the entity was approximately $8.5 billion. The Company's variable interests associated with these entities, primarily financial asset-backed securitization and collateralized debt and bond obligation entities, was approximately $120 million, which represents the Company's maximum exposure to loss at November 30, 2002. In connection with its investment management business, where the Company is the asset manager for collateralized bond and loan obligation entities, the aggregate size of potential VIEs at November 30, 2002 was approximately $2.5 billion. The Company's variable interests associated with its investment management activities was approximately $1 million, which represents the Company's maximum exposure to loss at November 30, 2002.

The Company purchases and sells interests in entities that may be deemed to be VIEs in its market-making capacity in the ordinary course of its institutional securities business. As a result of these activities, it is reasonably possible that such entities may be consolidated and deconsolidated at various points in time. Therefore, the Company's variable interests included above may not be held by the Company at its fiscal 2003 year-end.

3. Goodwill.

In June 2001, the FASB issued SFAS No. 142, which no longer permits the amortization of goodwill and indefinite-lived intangible assets. Instead, these assets must be reviewed annually (or more frequently under certain conditions) for impairment. Intangible assets that do not have indefinite lives will continue to be amortized over their useful lives and reviewed for impairment. The Company early adopted the provisions of SFAS No. 142 and therefore discontinued the amortization of goodwill effective December 1, 2001. During fiscal 2002, the Company completed the initial transitional goodwill impairment test, which did not indicate any goodwill impairment and therefore did not have an effect on the Company's consolidated financial condition or results of operations.

The following table presents a reconciliation of reported net income and earnings per share to the amounts adjusted for the exclusion of goodwill amortization, net of the related income tax effect:

	Fiscal 2002	Fiscal 2001	Fiscal 2000
	(dollars in millions, except per share amounts)		
Net income			
Income before extraordinary item and cumulative effect of accounting change	$2,988	$3,610	$5,456
Add: Goodwill amortization, net of tax	—	81	72
	2,988	3,691	5,528
Extraordinary item	—	(30)	—
Cumulative effect of accounting change	—	(59)	—
Adjusted	$2,988	$3,602	$5,528
Basic earnings per common share			
Basic before extraordinary item and cumulative effect of accounting change	$ 2.76	$ 3.29	$ 4.95
Add: Goodwill amortization, net of tax	—	0.07	0.07
	2.76	3.36	5.02
Extraordinary item	—	(0.03)	—
Cumulative effect of accounting change	—	(0.05)	—
Adjusted	$ 2.76	$ 3.28	$ 5.02
Diluted earnings per common share			
Diluted before extraordinary item and cumulative effect of accounting change	$ 2.69	$ 3.19	$ 4.73
Add: Goodwill amortization, net of tax	—	0.07	0.06
	2.69	3.26	4.79
Extraordinary item	—	(0.03)	—
Cumulative effect of accounting change	—	(0.05)	—
Adjusted	$ 2.69	$ 3.18	$ 4.79

Changes in the carrying amount of the Company's goodwill for fiscal 2002 were as follows:

	Institutional Securities	Individual Investor Group	Investment Management	Total
	(dollars in millions)			
Balance as of November 30, 2001	$ 4	$467	$967	$1,438
Translation adjustments	—	11	—	11
Balance as of November 30, 2002	$ 4	$478	$967	$1,449

4. Securities Financing and Securitization Transactions.

Securities purchased under agreements to resell ("reverse repurchase agreements") and Securities sold under agreements to repurchase ("repurchase agreements"), principally government and agency securities, are treated as financing transactions and are carried at the amounts at which the securities subsequently will be resold or reacquired as specified in the respective agreements; such amounts include accrued interest. Reverse repurchase agreements and repurchase agreements are presented on a net-by-counterparty basis, when appropriate. It is the Company's policy to take possession of securities purchased under agreements to resell. Securities borrowed and Securities loaned also are treated as financing transactions and are carried at the amounts of cash collateral advanced and received in connection with the transactions.

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

	At Nov. 30, 2002	At Nov. 30, 2001
	(dollars in millions)	
Financial instruments owned:		
U.S. government and agency securities	$ 9,144	$ 9,310
Other sovereign government obligations	83	—
Corporate and other debt	9,026	3,350
Corporate equities	1,849	2,850
Total	$20,102	$15,510

The Company enters into reverse repurchase agreements, repurchase agreements, securities borrowed transactions and securities loaned transactions to, among other things, finance the Company's inventory positions, acquire securities to cover short positions and settle other securities obligations and to accommodate customers' needs. The Company also engages in securities financing transactions for customers through margin lending. Under these agreements and transactions, the Company either receives or provides collateral, including U.S. government and agency securities, other sovereign government obligations, corporate and other debt, and corporate equities. The Company receives collateral in the form of securities in connection with reverse repurchase agreements, securities borrowed transactions and customer margin loans. In many cases, the Company is permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements, to enter into securities lending transactions or for delivery to counterparties to cover short positions. At November 30, 2002 and November 30, 2001, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was $376 billion and $355 billion, respectively, and the fair value of the portion that has been sold or repledged was $344 billion and $323 billion, respectively.

The Company manages credit exposure arising from reverse repurchase agreements, repurchase agreements, securities borrowed transactions and securities loaned transactions by, in appropriate circumstances, entering into master netting agreements and collateral arrangements with counterparties that provide the Company, in the event of a customer default, the right to liquidate collateral and the right to offset a counterparty's rights and obligations. The Company also monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralized. Where deemed appropriate, the Company's agreements with third parties specify its rights to request additional collateral. Customer receivables generated from margin lending activity are collateralized by customer-owned securities held by the Company. For these transactions, the Company's collateral policies significantly limit the Company's credit exposure in the event of customer default. The Company may request additional margin collateral from customers, if appropriate, and if necessary may sell securities that have not been paid for or purchase securities sold but not delivered from customers.

In connection with its Institutional Securities business, the Company engages in securitization activities related to commercial and residential mortgage loans, U.S. agency collateralized mortgage obligations, corporate bonds and loans, municipal bonds and other types of financial assets. These assets are carried at fair value, and any changes in fair value are recognized in the 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 consolidated statements of financial condition at fair value. Any changes in the fair value of such retained interests are recognized in the consolidated statements of income. Retained interests in securitized financial assets associated with the Company's Institutional Securities business were approximately $1.9 billion at November 30, 2002, the majority of which were related to residential mortgage loan, commercial mortgage loan and U.S. agency collateralized mortgage obligation securitization transactions. Gains or losses at the time of securitization, if any, were not material to the Company's results of operations, and the assumptions that the Company used to determine the fair value of its retained interests at the time of securitization were not materially different from the assumptions included in the table below. Additionally, as indicated in the table below, the Company's exposure to credit losses related to these retained interests was not material to the Company's results of operations.

The following table presents information on the Company's residential and commercial mortgage loan and U.S. agency collateralized mortgage obligation securitization transactions. Key economic assumptions and the sensitivity of the current fair value of the retained interests to immediate 10% and 20% adverse changes in those assumptions at November 30, 2002 were as follows (dollars in millions):

	Residential Mortgage Loans		U.S. Agency Collateralized Mortgage Obligations		Commercial Mortgage Loans
Retained interests (carrying amount/fair value)	$748	Retained interests (carrying amount/fair value)	$697	Retained interests (carrying amount/fair value)	$248
Weighted average life (in months)	14	Weighed average life (in months)	46	Weighted average life (in months)	62
Credit losses (rate per annum)	0.2-4.0%	Credit losses (rate per annum)	—	Credit losses (rate per annum)	0.45-13.0%
Impact on fair value of 10% adverse change	$(8)	Impact on fair value of 10% adverse change	—	Impact on fair value of 10% adverse change	$(1)
Impact on fair value of 20% adverse change	$(15)	Impact on fair value of 20% adverse change	—	Impact on fair value of 20% adverse change	$(1)
Weighted average discount rate (rate per annum)	15.16%	Weighted average discount rate (rate per annum)	5.11%	Weighted average discount rate (rate per annum)	5.55%
Impact on fair value of 10% adverse change	$(10)	Impact on fair value of 10% adverse change	$(11)	Impact on fair value of 10% adverse change	$(1)
Impact on fair value of 20% adverse change	$(20)	Impact on fair value of 20% adverse change	$(22)	Impact on fair value of 20% adverse change	$(2)
Prepayment speed assumption	275-1750PSA	Prepayment speed assumption	250-700PSA		
Impact on fair value of 10% adverse change	$(13)	Impact on fair value of 10% adverse change	$(1)		
Impact on fair value of 20% adverse change	$(23)	Impact on fair value of 20% adverse change	$(2)		

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 fiscal 2002, the Company received $43 billion of proceeds from new securitization transactions and $901 million of cash flows from retained interests in securitization transactions.

5. Consumer Loans.

Consumer loans were as follows:

	At Nov. 30, 2002	At Nov. 30, 2001
	(dollars in millions)	
General purpose credit card, mortgage and consumer installment	$24,332	$20,955
Less:		
Allowance for consumer loan losses	928	847
Consumer loans, net	$23,404	$20,108

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

	Fiscal 2002	Fiscal 2001	Fiscal 2000
	(dollars in millions)		
Balance beginning of period	$ 847	$ 783	$ 772
Additions:			
Provision for consumer loan losses	1,336	1,052	810
Deductions:			
Charge-offs	1,355	1,086	907
Recoveries	(100)	(98)	(108)
Net charge-offs	1,255	988	799
Balance end of period	$ 928	$ 847	$ 783

Interest accrued on general purpose credit card loans subsequently charged off, recorded as a reduction of interest revenue, was $229 million, $172 million and $127 million in fiscal 2002, fiscal 2001 and fiscal 2000, respectively.

At November 30, 2002 and November 30, 2001, $5,421 million and $5,037 million, respectively, of the Company's consumer loans had minimum contractual maturities of less than one year. Because of the uncertainty regarding consumer loan repayment patterns, which historically have been higher than contractually required minimum payments, this amount may not necessarily be indicative of the Company's actual consumer loan repayments.

At November 30, 2002, the Company had commitments to extend credit for consumer loans in the amount of approximately $260 billion. Commitments to extend credit arise primarily from agreements with customers for unused lines of credit on certain credit cards, provided there is no violation of conditions established in the related agreement. These commitments, substantially all of which the Company can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage and customer creditworthiness.

The Company received net proceeds from consumer loan asset securitizations of $4,048 million, $7,638 million and $10,294 million in fiscal 2002, fiscal 2001 and fiscal 2000, respectively.

The estimated fair value of the Company's consumer loans approximated carrying value at November 30, 2002 and November 30, 2001. The Company's domestic consumer loan portfolio, including securitized loans, is geographically diverse, with a distribution approximating that of the population of the U.S.

The Company's retained interests in credit card asset securitizations include an undivided seller's interest, cash collateral accounts, servicing rights and rights to any excess cash flows ("Residual Interests") remaining after payments to investors in the securitization trust of their contractual rate of return and reimbursement of credit losses. The undivided seller's interest less an applicable allowance for loan losses is recorded in Consumer loans. The Company's undivided seller's interest ranks *pari passu* with investors' interests in the securitization trust, and the remaining retained interests are subordinate to investors' interests. The cash collateral accounts are recorded in Other assets with the carrying value of the cash collateral accounts approximating fair value. The Company receives annual servicing fees of 2% of the investor principal balance outstanding. The Company does not recognize a servicing asset or a servicing liability for servicing rights since the servicing contract provides only adequate compensation (as defined in SFAS No. 140) to the Company for performing the servicing. Residual Interests are recorded in Other assets and classified as trading and reflected at fair value with changes in fair value recorded currently in earnings. On December 4, 2002, the Federal Deposit Insurance Corporation ("FDIC"), in conjunction with other bank regulatory agencies, issued guidance, *Interagency Advisory on the Accounting Treatment of Accrued Interest Receivable Related to Credit Card Securitizations*, for the purpose of clarifying the treatment of accrued interest and fees ("accrued interest receivable") on securitized credit card receivables as a subordinated retained interest for accounting purposes. At November 30, 2002, the accrued interest receivable was $0.6 billion. Including this accrued interest receivable amount, at November 30, 2002 the Company had $8.4 billion of retained interests, including $5.6 billion of undivided seller's interest, 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 trust have no recourse to the Company's other assets for failure of cardmembers to pay when due.

For fiscal 2002, the Company completed credit card asset securitizations of $3.6 billion and recognized net securitization gains of $20 million as servicing fees in the Company's consolidated statements of income. The uncollected balances of general purpose credit card loans sold through asset securitizations were $28.6 billion and $29.2 billion at November 30, 2002 and November 30, 2001, respectively.

Key economic assumptions used in measuring the Residual Interests at the date of securitization resulting from credit card asset securitizations completed during fiscal 2002 were as follows:

Weighted average life (in months)	5.8–6.2
Payment rate (rate per month)	16.88–17.75%
Credit losses (rate per annum)	6.45–6.95%
Discount rate (rate per annum)	14.00–16.50%

Key economic assumptions and the sensitivity of the current fair value of the Residual Interests to immediate 10% and 20% adverse changes in those assumptions were as follows (dollars in millions):

	At Nov. 30, 2002
Residual Interests (carrying amount/fair value)	$ 229
Weighted average life (in months)	5.8
Payment rate (rate per month)	17.75%
Impact on fair value of 10% adverse change	$ (16)
Impact on fair value of 20% adverse change	$ (29)
Credit losses (rate per annum)	6.45%
Impact on fair value of 10% adverse change	$ (68)
Impact on fair value of 20% adverse change	$ (136)
Discount rate (rate per annum)	14.00%
Impact on fair value of 10% adverse change	$ (2)
Impact on fair value of 20% adverse change	$ (5)

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 trust (dollars in billions):

	Fiscal 2002
Proceeds from new credit card asset securitizations	$ 3.6
Proceeds from collections reinvested in previous credit card asset securitizations	$53.3
Contractual servicing fees received	$ 0.6
Cash flows received from retained interests	$ 1.9

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

	At Nov. 30, 2002		Fiscal 2002	
	Loans Outstanding	Loans Delinquent	Average Loans	Net Credit Losses
Managed general purpose credit card loans	$51.1	$3.0	$49.8	$3.1
Less: Securitized general purpose credit card loans	28.6			
Owned general purpose credit card loans	$22.5			

6. Deposits.

Deposits were as follows:

	At Nov. 30, 2002	At Nov. 30, 2001
	(dollars in millions)	
Demand, passbook and money market accounts	$ 1,441	$ 1,741
Consumer certificate accounts	1,428	1,578
$100,000 minimum certificate accounts	10,888	8,957
Total	$13,757	$12,276

The weighted average interest rates of interest bearing deposits outstanding during fiscal 2002 and fiscal 2001 were 5.5% and 6.2%, respectively.

At November 30, 2002, certificate accounts maturing over the next five years were as follows:

Fiscal Year	(dollars in millions)
2003	$3,288
2004	3,201
2005	3,237
2006	1,794
2007	1,015

The estimated fair value of the Company's deposits, using current rates for deposits with similar maturities, approximated carrying value at November 30, 2002 and November 30, 2001.

7. Short-Term Borrowings.

At November 30, 2002 and November 30, 2001, commercial paper of $35,596 million and $25,158 million, respectively, with weighted average interest rates of 1.7% and 2.4%, respectively, was outstanding. During fiscal 2002 and fiscal 2001, the average amount of commercial paper outstanding was approximately $30,300 million and $28,800 million, respectively.

At November 30, 2002 and November 30, 2001, other short-term borrowings of $15,193 million and $7,684 million, respectively, were outstanding. These borrowings included bank loans, Federal Funds and bank notes. During fiscal 2002 and fiscal 2001, the average amount of other short-term borrowings outstanding was approximately $10,600 million and $8,300 million, respectively.

The Company maintains a senior revolving credit agreement with a group of banks to support general liquidity needs, including the issuance of commercial paper (the "MS Facility"). Under the terms of the MS Facility, the banks are committed to provide up to $5.5 billion. At November 30, 2002, the Company maintained an $8.4 billion surplus shareholders' equity as compared with the MS Facility's covenant requirement.

The Company maintains a master collateral facility that enables MS&Co., one of the Company's U.S. broker-dealer subsidiaries, to pledge certain collateral to secure loan arrangements, letters of credit and other financial accommodations (the "MS&Co. Facility"). As part of the MS&Co. Facility, MS&Co. also maintains a secured committed credit agreement with a group of banks that are parties to the master collateral facility under which such banks are committed to provide up to $1.875 billion. At November 30, 2002, MS&Co. maintained a $2.5 billion surplus consolidated stockholder's equity and a $3.2 billion surplus Net Capital, each as defined in the MS&Co. Facility and as compared with the MS&Co. Facility's covenant requirements.

The Company also maintains a revolving credit facility that enables MSIL, the Company's London-based broker-dealer subsidiary, to obtain committed funding from a syndicate of banks (the "MSIL Facility") by providing a broad range of collateral under repurchase agreements for a secured repo facility and a Company guarantee for an unsecured facility. The syndicate of banks is committed to provide up to an aggregate of $1.95 billion, available in six major currencies. At November 30, 2002, MSIL maintained a $1.5 billion surplus Shareholder's Equity and a $1.8 billion surplus Financial Resources, each as defined in the MSIL Facility and as compared with the MSIL Facility's covenant requirements.

MSJL, the Company's Tokyo-based broker-dealer subsidiary, maintains a committed revolving credit facility, guaranteed by the Company, that provides funding to support general liquidity needs, including support of MSJL's unsecured borrowings (the "MSJL Facility"). The MS Facility's covenant requirements described above apply to the Company as guarantor. Under the terms of the MSJL Facility, a syndicate of banks is committed to provide up to 70 billion Japanese yen.

The Company anticipates that it may utilize the MS Facility, the MS&Co. Facility, the MSIL Facility or the MSJL Facility (the "Credit Facilities") for short-term funding from time to time. The Company does not believe that any of the covenant requirements in any of its Credit Facilities will impair its ability to obtain funding under the Credit Facilities, to pay its current level of dividends, or to secure loan arrangements, letters of credit or other financial accommodations. At November 30, 2002, no borrowings were outstanding under any of the Credit Facilities.

The Company and its subsidiaries also maintain a series of committed credit facilities to support general liquidity needs. The facilities are expected to be drawn from time to time to cover short-term funding needs. Additionally, through one of its subsidiaries, the Company maintains a series of committed credit facilities to support the collateralized commercial mortgage whole loan business. The banks are committed to provide up to an aggregate of $1.0 billion.

8. Long-Term Borrowings.

Maturities and Terms. Long-term borrowings at fiscal year-end consisted of the following:

	U.S. Dollar			Non-U.S. Dollar(1)			At November 30,	
	Fixed Rate	Floating Rate(2)	Index/Equity Linked	Fixed Rate	Floating Rate(2)	Index/Equity Linked	2002 Total(3)	2001 Total
				(dollars in millions)				
Due in fiscal 2002	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$10,027
Due in fiscal 2003	4,138	5,173	783	942	1,155	195	12,386	10,570
Due in fiscal 2004	2,487	7,174	220	642	1,167	68	11,758	7,272
Due in fiscal 2005	3,305	196	138	2,364	178	236	6,417	5,953
Due in fiscal 2006	4,165	384	18	2,358	76	126	7,127	6,791
Due in fiscal 2007	4,305	25	10	58	522	106	5,026	2,170
Thereafter	9,511	67	552	2,133	68	116	12,447	6,885
Total	$27,911	$13,019	$1,721	$8,497	$3,166	$847	$55,161	$49,668
Weighted average coupon at fiscal year-end	6.7%	1.8%	n/a	4.7%	3.0%	n/a	4.9%	4.9%

(1) Weighted average coupon was calculated utilizing non-U.S. dollar interest rates.

(2) U.S. dollar contractual floating rate borrowings bear interest based on a variety of money market indices, including London Interbank Offered Rates ("LIBOR") and Federal Funds rates. Non-U.S. dollar contractual floating rate borrowings bear interest based on euro floating rates.

(3) Amounts include an increase of approximately $1,564 million to the carrying amount of certain of the Company's long-term borrowings associated with fair value hedges under SFAS No. 133.

Medium-Term Notes. Included in the table above are medium-term notes of $17,592 million and $18,390 million at November 30, 2002 and November 30, 2001, respectively. The weighted average interest rate on all medium-term notes was 2.6% in fiscal 2002 and 3.3% in fiscal 2001. Maturities of these notes range from fiscal 2003 through fiscal 2029.

Structured Borrowings. U.S. dollar index/equity linked borrowings include various structured instruments whose payments and redemption values are linked to the performance of a specific index (e.g., Standard & Poor's 500), a basket of stocks or a specific equity security. To minimize the exposure resulting from movements in the underlying equity position or index, the Company has entered into various equity swap contracts and purchased options that effectively convert the borrowing costs into floating rates based upon LIBOR. These instruments are included in the preceding table at their redemption values based on the performance of the underlying indices, baskets of stocks or specific equity securities.

Other Borrowings. Included in the Company's long-term borrowings are subordinated notes (including the notes issued by MS&Co. discussed below) of $663 million and $666 million at November 30, 2002 and November 30, 2001, respectively. The weighted average interest rate on these subordinated notes was 7.3% in fiscal 2002 and 7.4% in fiscal 2001. Maturities of the subordinated notes range from fiscal 2003 to fiscal 2016.

Certain of the Company's long-term borrowings are redeemable prior to maturity at the option of the holder. These notes contain certain provisions which effectively enable noteholders to put the notes back to the Company and, therefore, are scheduled in the foregoing table to mature in fiscal 2003 through fiscal 2009. The stated maturities of these notes, which aggregate $3,791 million, are from fiscal 2003 to fiscal 2032.

At November 30, 2002, MS&Co., a U.S. broker-dealer subsidiary of the Company, had outstanding $243 million of 8.51% fixed rate subordinated Series B notes, $96 million of 7.03% fixed rate subordinated Series D notes, $82 million of 7.28% fixed rate subordinated Series E notes and $25 million of 7.82% fixed rate subordinated Series F notes. These notes had maturities from fiscal 2003 to fiscal 2016. The terms of such notes contain restrictive covenants which require, among other things, that MS&Co. maintain specified levels of Consolidated Tangible Net Worth and Net Capital, each as defined. Subsequent to fiscal year-end, in December 2002, MS&Co. redeemed all $96 million of its 7.03% fixed rate subordinated Series D notes prior to their scheduled maturity.

Extinguishment of Long-Term Borrowings. During the third quarter of fiscal 2001, the Company recorded an extraordinary loss of $30 million, net of income taxes, resulting from the early extinguishment of certain long-term borrowings associated with the Company's aircraft financing activities.

Asset and Liability Management. In general, securities inventories and the majority of current assets are financed with a combination of short-term funding, floating rate long-term debt or fixed rate long-term debt swapped to a floating rate, and fixed assets are financed with fixed rate long-term debt. Both fixed rate and floating rate long-term debt (in addition to sources of funds accessed directly by the Company's Credit Services business) are used to finance the Company's consumer loan portfolio. The Company uses interest rate swaps to more closely match the duration of these borrowings to the duration of the assets being funded and to manage interest rate risk. These swaps effectively convert certain of the Company's fixed rate borrowings into floating rate obligations. In addition, for non-U.S. dollar currency borrowings that are not used to fund assets in the same currency, the Company has entered into currency swaps that effectively convert the borrowings into U.S. dollar obligations. The Company's use of swaps for asset and liability management affected its effective average borrowing rate as follows:

	Fiscal 2002	Fiscal 2001	Fiscal 2000
Weighted average coupon of long-term borrowings at fiscal year-end(1)	4.9%	4.9%	6.5%
Effective average borrowing rate for long-term borrowings after swaps at fiscal year-end(1)	2.9%	3.0%	6.7%

(1) Included in the weighted average and effective average calculations are non-U.S. dollar interest rates.

The effective weighted average interest rate on the Company's index/equity linked notes, which is not included in the table above, was 1.4% and 2.3% in fiscal 2002 and fiscal 2001, respectively, after giving effect to the related hedges.

The estimated fair value of the Company's long-term borrowings approximated carrying value based on rates available to the Company at year-end for borrowings with similar terms and maturities.

Cash paid for interest for the Company's borrowings and deposits approximated interest expense in fiscal 2002, fiscal 2001 and fiscal 2000.

9. Commitments and Contingencies.

The Company has non-cancelable operating leases covering office space and equipment. At November 30, 2002, future minimum rental commitments under such leases (net of subleases, principally on office rentals) were as follows:

Fiscal Year	(dollars in millions)
2003	$ 488
2004	454
2005	451
2006	408
2007	350
Thereafter	2,571

Occupancy lease agreements, in addition to base rentals, generally provide for rent and operating expense escalations resulting from increased assessments for real estate taxes and other charges. Total rent expense, net of sublease rental income, was $438 million, $423 million and $416 million in fiscal 2002, fiscal 2001 and fiscal 2000, respectively.

The Company has an agreement with IBM Corporation, expiring in June 2005, under which the Company receives information processing, data networking and related services. Under the terms of the agreement, the Company has an aggregate minimum annual calendar year commitment of $120 million through 2004 and a $60 million calendar year commitment in 2005, subject to annual cost-of-living adjustments.

At November 30, 2002 and November 30, 2001, the Company had approximately $3.6 billion and $4.5 billion, respectively, of letters of credit outstanding to satisfy various collateral requirements.

The Company has commitments to fund other less liquid investments, including at November 30, 2002 approximately $600 million in connection with its private equity and other principal investment activities. Additionally, the Company has provided and will continue to provide financing, including margin lending and other extensions of credit to clients (including subordinated loans on an interim basis to companies associated with its investment banking and its private equity and other principal investment activities), that may subject the Company to increased credit and liquidity risks.

In fiscal 2002, the Company purchased an office facility in Westchester County, New York. During fiscal 2002, the Company incurred costs of approximately $55 million, including the purchase price. The Company expects to incur additional project costs of approximately $265 million. The Company intends to occupy the building upon project completion, which currently is anticipated in the fourth quarter of fiscal 2003.

In connection with its aircraft financing business, the Company has entered into agreements to purchase aircraft and related equipment. As of November 30, 2002, the aggregate amount of such purchase commitments was $116 million. All of the aircraft and equipment to be acquired under these purchase obligations are subject to contractual lease arrangements.

At November 30, 2002, the Company had contracted to receive the following minimum rentals under operating leases in connection with its aircraft financing activities:

Fiscal Year	(dollars in millions)
2003	$ 469
2004	386
2005	299
2006	217
2007	173
Thereafter	1,020

In connection with certain of its business activities, the Company provides to corporate clients, on a selective basis, through subsidiaries (including Morgan Stanley Bank), loans or lending commitments, including bridge financing. The borrowers may be rated investment grade or non-investment grade. These loans and commitments have varying terms, may be senior or subordinated, are generally contingent upon representations, warranties and contractual conditions applicable to the borrower, and may be syndicated or traded by the Company. At November 30, 2002 and November 30, 2001, the aggregate value of investment grade loans and positions was $1.3 billion and $1.5 billion, respectively, and the aggregate value of non-investment grade loans and positions was $1.2 billion and $1.4 billion, respectively. At November 30, 2002 and November 30, 2001, the Company's aggregate investment grade lending commitments were $13.8 billion and $6.3 billion, respectively, and its aggregate non-investment grade lending commitments were $1.3 billion and $0.8 billion, respectively. In connection with these business activities (which include the loans and positions and lending commitments), the Company had hedges with a notional amount of $4.4 billion at November 30, 2002 and $1.4 billion at November 30, 2001. Requests to provide loans or lending commitments in connection with investment banking activities will continue and may grow in the future.

Financial instruments sold, not yet purchased represent obligations of the Company to deliver specified financial instruments at contracted prices, thereby creating commitments to purchase the financial instruments in the market at prevailing prices. Consequently, the Company's ultimate obligation to satisfy the sale of financial instruments sold, not yet purchased may exceed the amounts recognized in the consolidated statements of financial condition.

At November 30, 2002, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $37 billion and $34 billion, respectively.

In the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution, certain of which legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. The Company also is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies, certain of which may result in adverse judgments, fines or penalties. The number of these investigations and proceedings has increased in recent years with regard to many firms, including the Company. This increase has been exacerbated by the general decline of securities prices that began in 2000 and continued through the end of fiscal 2002. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or otherwise in financial distress.

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

On December 19, 2002, the Company (and other financial services firms) reached an agreement in principle with the Securities and Exchange Commission ("SEC"), the New York State Attorney General's Office, the New York Stock Exchange, Inc. ("NYSE"), the National Association of Securities Dealers, Inc. and the North American Securities Administrators Association (on behalf of state securities regulators) to resolve their investigations relating to alleged research analyst conflicts of interest. The agreement resolved the investigations as to the Company and the other firms but not as to individuals within the firms. Pursuant to the agreement in principle, the Company, without admitting or denying the allegations, agreed (i) to pay $50 million in retrospective relief and (ii) to adopt internal structural and operational practices that will further enhance the steps it already has taken to help ensure research analyst integrity and promote investor confidence. In addition, the Company agreed to provide independent third-party research to clients and to pay $75 million over five years to fund such research.

10. Earnings per Share.

Earnings per share were calculated as follows (in millions, except for per share data):

	Fiscal 2002	Fiscal 2001	Fiscal 2000
Basic EPS			
Income before extraordinary item and cumulative effect of accounting change	$2,988	$3,610	$5,456
Extraordinary item	—	(30)	—
Cumulative effect of accounting change	—	(59)	—
Preferred stock dividend requirements	—	(32)	(36)
Net income applicable to common shareholders	$2,988	$3,489	$5,420
Weighted average common shares outstanding	1,083	1,086	1,096
Basic EPS before extraordinary item and cumulative effect of accounting change	$ 2.76	$ 3.29	$ 4.95
Extraordinary item	—	(0.03)	—
Cumulative effect of accounting change	—	(0.05)	—
Basic EPS	$ 2.76	$ 3.21	$ 4.95

	Fiscal 2002	Fiscal 2001	Fiscal 2000
Diluted EPS			
Income before extraordinary item and cumulative effect of accounting change	$2,988	$3,610	$5,456
Extraordinary item	—	(30)	—
Cumulative effect of accounting change	—	(59)	—
Preferred stock dividend requirements	—	(32)	(36)
Net income applicable to common shareholders	$2,988	$3,489	$5,420
Weighted average common shares outstanding	1,083	1,086	1,096
Effect of dilutive securities:			
Stock options	26	35	47
Convertible debt	1	1	—
ESOP convertible preferred stock	—	—	2
Weighted average common shares outstanding and common stock equivalents	1,110	1,122	1,145
Diluted EPS before extraordinary item and cumulative effect of accounting change	$ 2.69	$ 3.19	$ 4.73
Extraordinary item	—	(0.03)	—
Cumulative effect of accounting change	—	(0.05)	—
Diluted EPS	$ 2.69	$ 3.11	$ 4.73

At November 30, 2002, there were approximately 65 million stock options outstanding for fiscal 2002 that were excluded from the computation of diluted EPS, as the exercise price of such options exceeded the average price per share of the Company's common stock.

11. Sales and Trading Activities.

The Company's institutional sales and trading activities are conducted through the integrated management of its client-driven and proprietary transactions along with the hedging and financing of these positions. While sales and trading activities are generated by client order flow, the Company also takes proprietary positions based on expectations of future market movements and conditions.

The Company's trading portfolios are managed with a view toward the risk and profitability of the portfolios. The nature of the equities and fixed income (including foreign exchange and commodities) activities conducted by the Company, including the use of derivative products in these businesses, and the market, credit and concentration risk management policies and procedures covering these activities are discussed below.

Equities. The Company makes markets and trades in the global secondary markets for equities and convertible debt and is a dealer in equity warrants, exchange traded and OTC equity options, exchange traded funds, index futures, equity swaps and other sophisticated equity derivatives. The Company's activities as a dealer primarily are client-driven, with the objective of meeting clients' needs while earning a spread between the premiums paid or received on its contracts with clients and the cost of hedging such transactions in the cash or forward market or with other derivative transactions. The Company limits its market risk related to these contracts, which stems primarily from underlying equity/index price and volatility movements, by employing a variety of hedging strategies. The Company also takes proprietary positions in the global equity markets by using derivatives, most commonly futures and options, in addition to cash positions, intending to profit from market price and volatility movements in the underlying equities or indices positioned.

Fixed Income. The Company trades and makes markets in domestic and international fixed income securities and related products, including preferred stock, investment grade corporate debt, high-yield securities, bank loans, U.S. and non-U.S. government securities, municipal securities, and commercial paper, money market and other short-term securities. The Company also makes markets in, and acts as principal with respect to, mortgage-related and other asset-backed securities and real estate loan products and provides financing to customers for commercial, residential and real estate loan products.

The Company is a dealer in interest rate and currency swaps and other related derivative products, credit derivatives (including credit default swaps), OTC options on U.S. and non-U.S. government bonds, and mortgage-backed forward agreements, options and swaps. The Company also acts as principal in aircraft finance transactions, under which the Company acquires aircraft outright or under leases.

The Company is a market-maker in a number of foreign currencies. It actively trades currencies with its customers on a principal basis in the spot, forward and currency option markets earning a dealer spread. In connection with its market-making activities, the Company seeks to manage its market risk by entering into offsetting positions. The Company also takes proprietary positions in currencies to profit from market price and volatility movements in the currencies positioned. The majority of the Company's foreign exchange business relates to major foreign currencies such as yen, euros, pounds sterling, Swiss francs and Canadian dollars. The balance of the business covers a broad range of other currencies.

The Company, as a major participant in the world commodities markets, trades in physical precious, base and platinum group metals, electricity, energy products (principally crude oil, refined oil products and natural gas) as well as a variety of derivatives related to these commodities such as futures, forwards, and exchange traded and OTC options and swaps. Through these activities, the Company provides clients with a ready market to satisfy end users' current raw material needs and facilitates their ability to hedge price fluctuations related to future inventory needs.

To facilitate hedging for its clients, the Company often is required to take positions in the commodity markets in the form of forward, option and swap contracts involving oil, natural gas, precious and base metals, and electricity. The Company also maintains proprietary trading positions in commodity derivatives, including futures, forwards and options in addition to physical commodities, to profit from price and volatility movements in the underlying commodities markets.

The following discussions of risk management, market risk, credit risk, concentration risk and customer activities relate to the Company's sales and trading activities.

Risk Management. Risk management at the Company is a multi-faceted process with independent oversight that requires constant communication, judgment and knowledge of specialized products and markets. The Company's senior management takes an active role in the risk management process and has developed policies and procedures that require specific administrative and business functions to assist in the identification, assessment and control of various risks. In recognition of the increasingly varied and complex nature of the global financial services business, the Company's risk management policies, procedures and methodologies are evolutionary in nature and are subject to ongoing review and modification. Many of the Company's risk management and control practices are subject to periodic review by the Company's Internal Audit Department as well as to interactions with various regulatory authorities.

The Management Committee, composed of the Company's most senior officers, establishes the Company's overall risk management policies and reviews its performance relative to these policies. The Management Committee has authorized the Securities Risk Committee to assist in monitoring and reviewing the Company's market risk management practices. The Securities Risk Committee has created sub-committees that report on specific risk management issues. These Risk Committees, as well as other committees established to manage and monitor specific risks, review the risk monitoring and risk management policies and procedures relating to the Company's market and credit risk profile, sales practices, legal enforceability, and operational and systems risks.

The Market Risk, Credit, Controllers, Treasury, and Law and Compliance Departments, which are all independent of the Company's business units, assist senior management and the Risk Committees in monitoring and controlling the Company's risk profile. The Market Risk and Credit Departments have operational responsibility for measuring and monitoring aggregate market risk and credit risk, respectively, with respect to the Company's institutional trading activities and are responsible for risk policy development, risk analysis and risk reporting to senior management and the Risk Committees. In addition, the Internal Audit Department, which reports to senior management and the Company's Audit Committee, periodically examines and evaluates the Company's operations and control environment. The Company is committed to employing qualified personnel with appropriate expertise in each of its various administrative and business areas to implement effectively the Company's risk management and monitoring systems and processes.

Market Risk. Market risk refers to the risk that a change in the level of one or more market prices, rates, indices, implied volatilities (the price volatility of the underlying instrument imputed from option prices), correlations or other market factors, such as liquidity, will result in losses for a position or portfolio.

The Company manages the market risk associated with its trading activities on a Company-wide basis, on a worldwide trading division level and on an individual product basis. Aggregate market risk limits have been approved for the Company and for its major trading divisions worldwide. Additional market risk limits are assigned to trading desks and, as appropriate, products and regions. Trading division risk managers, desk risk managers, traders and the Market Risk Department monitor market risk measures against limits in accordance with policies set by senior management.

The Market Risk Department independently reviews the Company's trading portfolios on a regular basis from a market risk perspective utilizing Value-at-Risk and other quantitative and qualitative risk measures and analyses. The Company's trading businesses and the Market Risk Department also use, as appropriate, measures such as sensitivity to changes in interest rates, prices, implied volatilities and time decay to monitor and report market risk exposures. Stress testing, which measures the impact on the value of existing portfolios of specified changes in market factors for certain products, is performed periodically and is reviewed by trading division risk managers, desk risk managers and the Market Risk Department. Reports summarizing material risk exposures are produced by the Market Risk Department and are disseminated to senior management.

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

The Company has credit guidelines that limit current and potential credit exposure to any one borrower or counterparty and to aggregates of borrowers or counterparties by type of business activity. The Credit Department administers these limits and monitors and reports credit exposure relative to limits.

Concentration Risk. The Company is subject to concentration risk by holding large positions in certain types of securities or commitments to purchase securities of a single issuer, including sovereign governments and other entities, issuers located in a particular country or geographic area, public and private issuers involving developing countries or issuers engaged in a particular industry. Financial instruments owned by the Company include U.S. government and agency securities and securities issued by other sovereign governments (principally Japan, Germany and the United Kingdom), which, in the aggregate, represented approximately 11% of the Company's total assets at November 30, 2002. In addition, substantially all of the collateral held by the Company for resale agreements or bonds borrowed, which together represented approximately 25% of the Company's total assets at November 30, 2002, consist of securities issued by the U.S. government, federal agencies or other sovereign government obligations. Positions taken and commitments made by the Company, including positions taken and underwriting and financing commitments made in connection with its private equity, principal investment and lending activities, often involve substantial amounts and significant exposure to individual issuers and businesses, including non-investment grade issuers. The Company seeks to limit concentration risk through the use of the systems and procedures described in the preceding discussions of risk management, market risk and credit risk.

Customer Activities. The Company's customer activities involve the execution, settlement and financing of various securities and commodities transactions on behalf of customers. Customer securities activities are transacted on either a cash or margin basis. Customer commodities activities, which include the execution of customer transactions in commodity futures transactions (including options on futures), are transacted on a margin basis.

The Company's customer activities may expose it to off-balance sheet credit risk. The Company may have to purchase or sell financial instruments at prevailing market prices in the event of the failure of a customer to settle a trade on its original terms or in the event cash and securities in customer margin accounts are not sufficient to fully cover customer losses. The Company seeks to control the risks associated with customer activities by requiring customers to maintain margin collateral in compliance with various regulations and Company policies.

Fair Value of Derivatives. 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 distressed sale, and is further described in Note 2. 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 consolidated statements of financial condition. The amounts in the following table represent unrealized gains and losses on exchange traded and OTC options and other contracts (including interest rate, foreign exchange, and other forward contracts and swaps) for derivatives used by the Company for trading and investment and for asset and liability management, net of offsetting positions in situations where netting is appropriate. The asset amounts are not reported net of collateral, which the Company obtains with respect to certain of these transactions to reduce its exposure to credit losses (see "Quantitative and Qualitative Disclosures about Market Risk — Risk Management — Credit Risk" in Part II, Item 7A).

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 November 30, 2002 will not have a material effect on the Company's financial condition.

The Company's derivatives (both listed and OTC) at November 30, 2002 and November 30, 2001 are summarized in the table below, showing the fair value of the related assets and liabilities by product:

	At November 30, 2002		At November 30, 2001	
	Assets	Liabilities	Assets	Liabilities
	(dollars in millions)			
Interest rate and currency swaps and options, credit derivatives and other fixed income securities contracts	$25,456	$18,225	$19,120	$16,957
Foreign exchange forward contracts and options	2,308	2,508	2,698	2,579
Equity securities contracts (including equity swaps, warrants and options)	3,933	4,472	4,341	2,263
Commodity forwards, options and swaps	3,918	3,780	5,919	5,487
Total	$35,615	$28,985	$32,078	$27,286

12. Preferred Stock, Capital Units and Preferred Securities Subject to Mandatory Redemption.

Preferred stock of the Company was as follows:

	Shares Outstanding at November 30,		Balance at November 30,	
	2002	2001	2002	2001
			(dollars in millions)	
Series A Fixed/Adjustable Rate Cumulative Preferred Stock, stated value $200 per share	—	1,725,000	$ —	$345

In fiscal 2002, the Company redeemed all 1,725,000 outstanding shares of its Series A Fixed/Adjustable Rate Cumulative Preferred Stock at a redemption price of $200 per share. The Company also simultaneously redeemed all corresponding Depositary Shares at a redemption price of $50 per Depositary Share. Each Depositary Share represented ¼ of a share of the Company's Series A Fixed/Adjustable Rate Cumulative Preferred Stock.

The Company has Capital Units outstanding that were issued by the Company and Morgan Stanley Finance plc ("MSF"), a U.K. subsidiary. A Capital Unit consists of (a) a Subordinated Debenture of MSF guaranteed by the Company and maturing in 2017 and (b) a related Purchase Contract issued by the Company, which may be accelerated by the Company, requiring the holder to purchase one Depositary Share representing shares (or fractional shares) of the Company's Cumulative Preferred Stock. The aggregate amount of Capital Units outstanding was $66 million at November 30, 2002 and November 30, 2001, respectively.

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

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

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

Preferred Securities Subject to Mandatory Redemption	**Capital Trust I**	**Capital Trust II**
Issuance date	March 12, 1998	July 19, 2001
Preferred securities issued	16,000,000	32,400,000
Liquidation preference per security	$25	$25
Liquidation value (in millions)	$400	$810
Coupon rate	7.10%	7.25%
Distribution payable	Quarterly	Quarterly
Distributions guaranteed by	Morgan Stanley	Morgan Stanley
Mandatory redemption date	February 28, 2038	July 31, 2031(1)
Redeemable by issuer on or after(2)	March 12, 2003	July 31, 2006
Junior Subordinated Deferrable Interest Debentures		
Principal amount outstanding (in millions)(3)	$412	$835
Coupon rate	7.10%	7.25%
Interest payable	Quarterly	Quarterly
Maturity date	February 28, 2038	July 31, 2031(1)
Redeemable by issuer on or after(2)	March 12, 2003	July 31, 2006

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

13. Shareholders' Equity.

MS&Co. and MSDWI are registered broker-dealers and registered futures commission merchants and, accordingly, are subject to the minimum net capital requirements of the SEC, the NYSE and the Commodity Futures Trading Commission. MS&Co. and MSDWI have consistently operated in excess of these requirements. MS&Co.'s net capital totaled $4,996 million at November 30, 2002, which exceeded the amount required by $4,428 million. MSDWI's net capital totaled $1,320 million at November 30, 2002, which exceeded the amount required by $1,219 million. MSIL, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Authority, and MSJL, a Tokyo-based broker-dealer, is subject to the capital requirements of the Financial Services Agency. MSIL and MSJL have consistently operated in excess of their respective regulatory capital requirements.

Under regulatory capital requirements adopted by the FDIC and other bank regulatory agencies, FDIC-insured financial institutions must maintain (a) 3% to 5% of Tier 1 capital, as defined, to average assets ("leverage ratio"), (b) 4% of Tier 1 capital, as defined, to risk-weighted assets ("Tier 1 risk-weighted capital ratio") and

(c) 8% of total capital, as defined, to risk-weighted assets ("total risk-weighted capital ratio"). At November 30, 2002, the leverage ratio, Tier 1 risk-weighted capital ratio and total risk-weighted capital ratio of each of the Company's FDIC-insured financial institutions exceeded these regulatory minimums.

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

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.

The regulatory capital requirements referred to above, and certain covenants contained in various agreements governing indebtedness of the Company, may restrict the Company's ability to withdraw capital from its subsidiaries. At November 30, 2002, approximately $6.2 billion of net assets of consolidated subsidiaries may be restricted as to the payment of cash dividends and advances to the Company.

The Company repurchased approximately 22 million and 25 million shares of its common stock (through a combination of open market purchases and the settlement of put options) in fiscal 2002 and fiscal 2001, respectively.

Cumulative translation adjustments include gains or losses resulting from translating foreign currency financial statements from their respective functional currencies to U.S. dollars, net of hedge gains or losses and related tax effects. The Company uses foreign currency contracts and designates certain non-U.S. dollar currency debt as hedges to manage the currency exposure relating to its net monetary investments in non-U.S. dollar functional currency subsidiaries. Increases or decreases in the value of the Company's net foreign investments generally are tax deferred for U.S. purposes, but the related hedge gains and losses are taxable currently. The Company attempts to protect its net book value from the effects of fluctuations in currency exchange rates on its net monetary investments in non-U.S. dollar subsidiaries by selling the appropriate non-U.S. dollar currency in the forward market. However, under some circumstances, the Company may elect not to hedge its net monetary investments in certain foreign operations due to market conditions, including the availability of various currency contracts at acceptable costs. Information relating to the hedging of the Company's net monetary investments in non-U.S. dollar functional currency subsidiaries and their effects on cumulative translation adjustments is summarized below:

	At November 30,	
	2002	2001
	(dollars in millions)	
Net monetary investments in non-U.S. dollar functional currency subsidiaries	$2,587	$2,354
Cumulative translation adjustments resulting from net investments in subsidiaries with a non-U.S. dollar functional currency	$ (147)	$ (334)
Cumulative translation adjustments resulting from realized or unrealized gains on hedges, net of tax	27	184
Total cumulative translation adjustments	$ (120)	$ (150)

14. Employee Compensation Plans.

The Company has adopted a variety of compensation plans for certain of its employees. These plans are designed to facilitate a pay-for-performance policy, provide compensation commensurate with other leading financial services companies and provide for internal stock ownership in order to align the interests of employees with the long-term interests of the Company's shareholders. Certain of these plans are summarized below.

Equity-Based Compensation Plans. The Company is authorized to issue up to approximately 618 million shares of its common stock in connection with awards under its equity-based compensation plans. At November 30, 2002, approximately 206 million shares were available for future grant under these plans.

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

The following table sets forth activity relating to the Company's stock option awards (share data in millions):

	Fiscal 2002		Fiscal 2001		Fiscal 2000	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding at beginning of period	151.4	$38.88	137.6	$34.87	131.3	$26.76
Granted(1)	22.8	43.66	24.5	57.56	25.5	67.41
Exercised	(7.6)	19.40	(8.1)	21.85	(17.8)	21.26
Forfeited	(2.9)	57.94	(2.6)	56.14	(1.4)	40.10
Options outstanding at end of period	163.7	$40.11	151.4	$38.88	137.6	$34.87
Options exercisable at end of period	91.2	$30.02	92.4	$27.71	88.3	$26.74

(1) Amounts include stock options granted to employees subsequent to fiscal year-end but as part of year-end compensation for the fiscal year.

The following table presents information relating to the Company's stock options outstanding at November 30, 2002 (share data in millions):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Exercise Price	Average Remaining Life (Years)	Number Exercisable	Weighted Average Exercise Price
$ 4.00 – $ 19.99	34.6	$ 9.45	2.0	31.7	$ 9.50
$20.00 – $ 29.99	23.5	26.75	4.1	23.0	26.74
$30.00 – $ 39.99	16.8	35.56	6.0	15.3	35.54
$40.00 – $ 49.99	24.2	42.84	9.3	3.3	44.11
$50.00 – $ 59.99	25.8	56.54	8.6	2.4	53.14
$60.00 – $ 69.99	35.8	63.20	7.4	13.2	60.92
$70.00 – $107.99	3.0	84.80	5.8	2.3	86.21
Total	163.7		6.1	91.2	

Deferred Compensation Awards. The Company has made deferred compensation awards pursuant to several equity-based compensation plans. These plans provide for the deferral of a portion of certain key employees' compensation with payments made in the form of the Company's common stock or in the right to receive unrestricted shares (collectively, "Restricted Stock"). The Company recognizes compensation expense related to Restricted Stock awards in the year for which employee services are performed. An award is deemed to relate to past services and is charged to compensation expense in its entirety in the year in which services are performed, thereby matching the compensation expense with related revenues. Compensation expense for all such awards (including those subject to forfeiture) amounted to $450 million, $612 million and $855 million in fiscal 2002, fiscal 2001 and fiscal 2000, respectively. Compensation expense for Restricted Stock awards was determined based on the fair value of the Company's common stock as defined in the plans (e.g., volume-weighted average price of the Company's common stock on the date of grant for fiscal 2002 awards.) The number of Restricted Stock shares outstanding was 80 million at November 30, 2002, 96 million at November 30, 2001 and 115 million at November 30, 2000.

Restricted Stock awarded under these plans are subject to restrictions on sale, transfer or assignment until the end of a specified restriction period, generally five to 10 years from the date of grant. Holders of Restricted Stock generally may forfeit ownership of all or a portion of their award if employment is terminated before the end of the relevant restriction period. Holders of vested Restricted Stock generally also will forfeit ownership in certain limited situations, including termination for cause during the restriction period.

Profit Sharing Plans. The Company sponsors a qualified profit sharing plan covering substantially all U.S. employees and also provides cash payment of profit sharing to employees of its international subsidiaries. Contributions are made to eligible employees at the discretion of the Board of Directors based upon the financial performance of the Company. Profit sharing expense for fiscal 2002, fiscal 2001 and fiscal 2000 was $104 million, $149 million and $182 million, respectively.

Employee Stock Ownership Plan. The Company has a $140 million leveraged employee stock ownership plan, funded through an independently managed trust. The Employee Stock Ownership Plan ("ESOP") was established to broaden internal ownership of the Company and to provide benefits to its employees in a cost-effective manner. In January 2000, each share of the ESOP Convertible Preferred Stock was converted into 6.6 common shares of the Company. The ESOP trust funded its stock purchase through a loan of $140 million from the Company. The ESOP trust note, due September 19, 2005 (extendible at the option of the ESOP trust to September 19, 2010), bears a 10-3⁄8% interest rate per annum with principal payable without penalty on or before the due date. The ESOP trust expects to make principal and interest payments on the note from funds provided by dividends on the shares of common stock and contributions from the Company, if required. The note receivable from the ESOP trust is reflected as a reduction in the Company's shareholders' equity. Shares allocated to employees generally may not be withdrawn until the employee's death, disability, retirement or termination. Contributions to the ESOP by the Company and allocation of ESOP shares to employees are made annually at the discretion of the Board of Directors based on the financial performance of the Company. The cost of shares allocated to participants' accounts amounted to $18 million in fiscal 2002, $13 million in fiscal 2001 and $11 million in fiscal 2000. The ESOP debt service costs for fiscal 2002 and fiscal 2001 were paid from dividends received on stock held by the ESOP trust and from Company contributions. The ESOP debt service costs for fiscal 2000 were paid from dividends received on stock held by the ESOP trust.

Pro Forma Effect of SFAS No. 123. Had the Company elected to recognize compensation cost pursuant to SFAS No. 123 for its stock option plans and its employee stock purchase plan, net income would have been reduced by $250 million, $375 million and $488 million for fiscal 2002, fiscal 2001 and fiscal 2000, respectively, resulting in pro forma net income and earnings per share as follows:

	Fiscal 2002	Fiscal 2001	Fiscal 2000
	(dollars in millions, except per share data)		
Net income			
As reported	$2,988	$3,521	$5,456
Pro forma	2,738	3,146	4,968
Earnings per share			
As reported:			
Basic	$ 2.76	$ 3.21	$ 4.95
Diluted	2.69	3.11	4.73
Pro forma:			
Basic	$ 2.53	$ 2.87	$ 4.50
Diluted	2.45	2.76	4.29

The weighted average fair value at date of grant for stock options granted during fiscal 2002, fiscal 2001 and fiscal 2000 was $19.42, $26.43 and $30.48 per option, respectively. The fair value of stock options at date of grant was estimated using the Black-Scholes option pricing model utilizing the following weighted average assumptions:

	Fiscal 2002	Fiscal 2001	Fiscal 2000
Risk-free interest rate	3.8%	4.7%	5.6%
Expected option life in years	6.2	6.1	5.3
Expected stock price volatility	50.7%	48.4%	43.4%
Expected dividend yield	1.9%	1.5%	1.1%

15. Employee Benefit Plans.

The Company sponsors various pension plans for the majority of its worldwide employees. The Company provides certain other postretirement benefits, primarily health care and life insurance, to eligible employees. The Company also provides certain benefits to former employees or inactive employees prior to retirement. The following summarizes these plans:

Pension Plans. Substantially all of the U.S. employees of the Company and its U.S. affiliates are covered by non-contributory pension plans that are qualified under Section 401(a) of the Internal Revenue Code (the “Qualified Plans”). Unfunded supplementary plans (the “Supplemental Plans”) cover certain executives. In addition to the Qualified Plans and the Supplemental Plans (collectively, the “U.S. Plans”), certain of the Company’s international subsidiaries also have pension plans covering substantially all of their employees. These pension plans generally provide pension benefits that are based on each employee’s years of credited service and on compensation levels specified in the plans. For the Qualified Plans and the other international plans, the Company’s policy is to fund at least the amounts sufficient to meet minimum funding requirements under applicable employee benefit and tax regulations. Liabilities for benefits payable under the Supplemental Plans are accrued by the Company and are funded when paid to the beneficiaries.

The following tables present information for the Company's pension plans on an aggregate basis.

Pension expense included the following components:

	Fiscal 2002	Fiscal 2001	Fiscal 2000
	(dollars in millions)		
U.S. Plans:			
Service cost, benefits earned during the period	$ 80	$ 77	$ 74
Interest cost on projected benefit obligation	107	96	88
Expected return on plan assets	(106)	(110)	(100)
Net amortization	8	1	6
Net settlements and curtailments	24	—	2
Special termination benefits	5	—	—
Total U.S. plans	118	64	70
Total international plans	3	4	4
Net pension expense	$ 121	$ 68	$ 74

The following table provides the assumptions used in determining the Company's benefit obligation for the U.S. Plans:

	Fiscal 2002	Fiscal 2001
Year-end discount rate	6.75%	7.55%
Weighted average rate of increase in future compensation levels	5.00%	5.00%
Expected long-term rate of return on plan assets for fiscal year	8.50%	9.00%

The following table provides a reconciliation of the changes in the U.S. Plans' benefit obligation and fair value of plan assets for fiscal 2002 and fiscal 2001 as well as a summary of the U.S. Plans' funded status at November 30, 2002 and November 30, 2001:

	Fiscal 2002	Fiscal 2001
	(dollars in millions)	
Reconciliation of benefit obligation:		
Benefit obligation at beginning of year	$1,457	$1,234
Service cost	80	77
Interest cost	107	96
Plan amendments	11	—
Actuarial loss or (gain)	246	136
Benefits paid	(154)	(86)
Curtailments	(31)	—
Special termination benefits	5	—
Benefit obligation at end of year	$1,721	$1,457
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	$1,057	$1,268
Actual return on plan assets	(75)	(198)
Employer contributions	458	73
Benefits paid and settlements	(154)	(86)
Fair value of plan assets at end of year	$1,286	$1,057
Funded status:		
Funded status	$ (435)	$ (400)
Amount contributed to plan after measurement date	1	20
Unrecognized transition obligation	—	2
Unrecognized prior-service cost	29	22
Unrecognized loss or (gain)	665	295
Net amount recognized	$ 260	$ (61)
Amounts recognized in the consolidated statements of financial condition consist of:		
Prepaid benefit cost	$ 446	$ 117
Accrued benefit liability	(216)	(184)
Intangible asset	4	6
Accumulated other comprehensive income	26	—
Net amount recognized	$ 260	$ (61)

In accordance with SFAS No. 87, "Employers' Accounting for Pensions," the Company recorded an additional minimum pension liability of $30 million at November 30, 2002 for defined benefit pension plans whose accumulated benefits exceeded plan assets. A corresponding amount was recognized as an intangible asset, to the extent of unrecognized prior-service cost. The remaining balance of $26 million ($19 million net of income taxes) was recorded as a reduction of Accumulated other comprehensive income, a component of shareholders' equity.

For the Supplemental Plans, the aggregate accumulated benefit obligation was $130 million and $126 million at November 30, 2002 and November 30, 2001, respectively.

The Company also maintains separate defined contribution pension plans that cover substantially all employees of certain non-U.S. subsidiaries. Under such plans, benefits are determined by the purchasing power of the accumulated value of contributions paid. In fiscal 2002, fiscal 2001 and fiscal 2000, the Company's expense related to these plans was $62 million, $68 million and $46 million, respectively.

Postretirement Benefits. The Company has unfunded postretirement benefit plans that provide medical and life insurance for eligible retirees and dependents. At November 30, 2002 and November 30, 2001, the Company's accrued postretirement benefit liability was $122 million and $112 million, respectively.

Postemployment Benefits. Postemployment benefits include, but are not limited to, salary continuation, severance benefits, disability-related benefits, and continuation of health care and life insurance coverage provided to former employees or inactive employees after employment but before retirement. These benefits were not material to the Company's consolidated financial statements in fiscal 2002, fiscal 2001 and fiscal 2000.

16. Income Taxes.

The provision for income taxes consisted of:

	Fiscal 2002	Fiscal 2001	Fiscal 2000
	(dollars in millions)		
Current:			
U.S. federal	$1,189	$2,014	$2,299
U.S. state and local	132	227	387
Non-U.S.	269	260	603
	1,590	2,501	3,289
Deferred:			
U.S. federal	20	(550)	(140)
U.S. state and local	15	(61)	(44)
Non-U.S.	20	184	(35)
	55	(427)	(219)
Provision for income taxes	$1,645	$2,074	$3,070

The following table reconciles the provision to the U.S. federal statutory income tax rate:

	Fiscal 2002	Fiscal 2001	Fiscal 2000
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
U.S. state and local income taxes, net of U.S. federal income tax benefits	2.0	1.9	2.5
Lower tax rates applicable to non-U.S. earnings	(2.2)	(0.4)	(2.0)
Other	0.1	(0.3)	0.4
Effective income tax rate	34.9%	36.2%	35.9%

As of November 30, 2002, the Company had approximately $4.0 billion of earnings attributable to foreign subsidiaries for which no provisions have been recorded for income tax that could occur upon repatriation. Except to the extent such earnings can be repatriated tax efficiently, they are permanently invested abroad. It is not practicable to determine the amount of income taxes payable in the event all such foreign earnings are repatriated.

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. Significant components of the Company's deferred tax assets and liabilities at November 30, 2002 and November 30, 2001 were as follows:

	Nov. 30, 2002	Nov. 30, 2001
	(dollars in millions)	
Deferred tax assets:		
Employee compensation and benefit plans	$2,239	$1,898
Loan loss allowance	344	289
Other valuation and liability allowances	928	923
Deferred expenses	70	17
Other	422	378
Total deferred tax assets	4,003	3,505
Deferred tax liabilities:		
Prepaid commissions	222	137
Other	822	338
Total deferred tax liabilities	1,044	475
Net deferred tax assets	$2,959	$3,030

Cash paid for income taxes was $1,252 million, $910 million and $3,401 million in fiscal 2002, fiscal 2001 and fiscal 2000, respectively.

The Company recorded income tax benefits of $282 million, $460 million and $467 million related to employee stock compensation transactions in fiscal 2002, fiscal 2001 and fiscal 2000, respectively. Such benefits were credited to paid-in capital.

17. Segment and Geographic Information.

Pursuant to SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," which establishes standards for disclosures that relate to business operating segments ("segments"), the Company structures its segments primarily based upon the nature of the financial products and services provided to customers and the Company's management organization. The Company provides a wide range of financial products and services to its customers in each of its business segments: Institutional Securities, Individual Investor Group, Investment Management and Credit Services.

The Company's Institutional Securities business includes securities underwriting and distribution; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; sales, trading, financing and market-making activities in equity securities and related products and fixed income securities and related products, including foreign exchange and commodities; principal investing and aircraft financing activities. The Company's Individual Investor Group business provides comprehensive financial planning and investment advisory services designed to accommodate individual investment goals and risk profiles. The Company's Investment Management business provides global asset management products and services for individual and institutional investors through three principal distribution channels: a proprietary channel consisting of the Company's financial advisors and investment representatives; a non-proprietary channel consisting of third-party broker-dealers, banks, financial planners and other intermediaries; and the

Company's institutional channel. The Company's private equity activities also are included within the Investment Management business segment. The Company's Credit Services business offers Discover-branded cards and other consumer finance products and services and includes the operation of Discover Business Services, a network of merchant and cash access locations primarily in the U.S. Revenues and expenses directly associated with each respective segment are included in determining their operating results. Other revenues and expenses that are not directly attributable to a particular segment are allocated based upon the Company's allocation methodologies, generally based on each segment's respective revenues or other relevant measures.

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

Fiscal 2002	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Total
	(dollars in millions)				
Net revenues excluding net interest	$ 6,988	$3,752	$2,279	$2,194	$15,213
Net interest	2,280	228	25	1,363	3,896
Net revenues	$ 9,268	$3,980	$2,304	$3,557	$19,109
Income (loss) before income taxes and dividends on preferred securities subject to mandatory redemption	$ 2,704	$ (15)	$ 842	$1,189	$ 4,720
Income tax provision (benefit)	914	(8)	317	422	1,645
Dividends on preferred securities subject to mandatory redemption	87	—	—	—	87
Net income (loss)	$ 1,703	$ (7)	$ 525	$ 767	$ 2,988

Fiscal 2001(1)	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Total
	(dollars in millions)				
Net revenues excluding net interest	$ 9,944	$4,086	$2,463	$2,202	$18,695
Net interest	1,610	369	62	1,357	3,398
Net revenues	$11,554	$4,455	$2,525	$3,559	$22,093
Income (loss) before income taxes, dividends on preferred securities subject to mandatory redemption, extraordinary item and cumulative effect of accounting change	$ 3,839	$ (61)	$ 829	$1,127	$ 5,734
Income tax provision (benefit)	1,317	(17)	349	425	2,074
Dividends on preferred securities subject to mandatory redemption	50	—	—	—	50
Income (loss) before extraordinary item and cumulative effect of accounting change	2,472	(44)	480	702	3,610
Extraordinary item	(30)	—	—	—	(30)
Cumulative effect of accounting change	(46)	—	—	(13)	(59)
Net income (loss)	$ 2,396	$ (44)	$ 480	$ 689	$ 3,521

Fiscal 2000(1)	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Total
	(dollars in millions)				
Net revenues excluding net interest	$13,246	$5,069	$2,784	$1,963	$23,062
Net interest	846	637	86	1,517	3,086
Net revenues	$14,092	$5,706	$2,870	$3,480	$26,148
Gain on sale of business	$ —	$ —	$ 35	$ —	$ 35
Income before income taxes and dividends on preferred securities subject to mandatory redemption	$ 5,407	$ 893	$1,110	$1,144	$ 8,554
Provision for income taxes	1,815	387	449	419	3,070
Dividends on preferred securities subject to mandatory redemption	28	—	—	—	28
Net income	$ 3,564	$ 506	$ 661	$ 725	$ 5,456

Total Assets(1)(2)	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Total
			(dollars in millions)		
November 30, 2002	$487,718	$ 8,207	$5,131	$28,443	$529,499
November 30, 2001	$442,598	$ 9,823	$5,076	$25,131	$482,628
November 30, 2000	$372,236	$17,275	$4,872	$26,896	$421,279

(1) Prior to fiscal 2002, the results of the Company's institutional and individual securities activities were aggregated into one reporting segment. In addition, the operating results of the Investment Management business segment includes the Company's private equity activities. Prior to fiscal 2002, private equity activities were included within the Company's Institutional Securities business segment. The segment data for all periods presented have been restated to reflect these changes.

(2) Corporate assets have been fully allocated to the Company's business segments.

Allocation decisions in global financial services businesses are by their nature complex and subjective and involve a high degree of judgment. Management currently is evaluating the segment allocation methodology, and the effect of any changes may be material to a particular segment. Therefore, business segment results in the future may reflect reallocations of revenues and expenses that result from such changes. Reallocations of revenues or expenses among segments will have no effect on the Company's overall results of operations.

The Company operates in both U.S. and non-U.S. markets. The Company's non-U.S. business activities are principally conducted through European and Asian locations. The following table presents selected income statement information and the total assets of the Company's operations by geographic area. The principal methodologies used in preparing the geographic area data are as follows: commission revenues are recorded based on the location of the sales force; trading revenues are principally recorded based on location of the trader; investment banking revenues are based on location of the client; and asset management and portfolio service fees are recorded based on the location of the portfolio manager:

Fiscal 2002	U.S.	Europe	Asia	Other	Eliminations	Total
			(dollars in millions)			
Net revenues	$ 14,545	$ 3,349	$ 1,432	$ 297	$ (514)	$19,109
Income before income taxes and dividends on preferred securities subject to mandatory redemption	3,197	848	405	270	—	4,720
Total assets at November 30, 2002	640,132	246,979	31,795	20,329	(409,736)	529,499

Fiscal 2001	U.S.	Europe	Asia	Other	Eliminations	Total
			(dollars in millions)			
Net revenues	$ 16,931	$ 3,956	$ 1,501	$ 103	$ (398)	$22,093
Income before income taxes, dividends on preferred securities subject to mandatory redemption, extraordinary item and cumulative effect of accounting change	4,208	1,137	306	83	—	5,734
Total assets at November 30, 2001	536,211	233,956	28,582	18,817	(334,938)	482,628

Fiscal 2000	U.S.	Europe	Asia	Other	Eliminations	Total
			(dollars in millions)			
Net revenues	$ 19,640	$ 4,920	$ 1,787	$ 121	$ (320)	$26,148
Income before income taxes and dividends on preferred securities subject to mandatory redemption	6,361	1,587	513	93	—	8,554
Total assets at November 30, 2000	468,055	206,131	23,652	19,132	(295,691)	421,279

18. Business Acquisitions, Business Disposition and Asset Dispositions.

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

In fiscal 2002, the Company recorded a pre-tax gain of $73 million related to the sale of a 1 million square-foot office tower in New York City that had been under construction since 1999. The pre-tax gain is included within the Institutional Securities ($53 million), Individual Investor Group ($7 million) and Investment Management ($13 million) business segments. The allocation was based upon occupancy levels originally planned for the building.

In fiscal 2001, the Company acquired Quilter, a U.K.-based private client investment management business providing segregated account management and advisory services to individuals, pension funds and trusts. The Company's fiscal 2001 results include the operations of Quilter since March 13, 2001, the date of acquisition.

In fiscal 2000, the Company acquired Ansett Worldwide, one of the world's leading aircraft leasing groups, leasing new and used commercial jet aircraft to airlines around the world. The Company's fiscal 2000 results include the operations of Ansett Worldwide since April 27, 2000, the date of acquisition.

In the fourth quarter of fiscal 1998, the Company sold its Global Custody business to The Chase Manhattan Corporation ("Chase"). At that time, the Company recorded a pre-tax gain of $323 million from the sale. Such gain included estimates for certain payments and purchase price adjustments which, under certain circumstances pursuant to the sales agreement, were payable by the Company to Chase. As a result of the resolution of these payments and purchase price adjustments, the Company recorded an additional pre-tax gain of $35 million related to the sale of its Global Custody business in fiscal 2000.

The pro forma impact of each of the above business acquisitions was not material to the Company's consolidated financial statements.

19. Asset Impairment.

The Company's aircraft financing business has continued to be adversely affected by the slowdown in the commercial aircraft industry that began in early 2001 and was exacerbated by the terrorist attacks of September 11, 2001 (see Note 20). In addition, the continuing reduction in aircraft passenger volume has resulted in the grounding of a significant number of aircraft. Such conditions have contributed significantly to the decline in lease rates for operating lessors, including the Company's aircraft financing business. As a result of these conditions and in accordance with SFAS No. 121, the Company incurred non-cash pre-tax charges of $74 million in the third quarter of fiscal 2002 and $87 million in the fourth quarter of fiscal 2001 to reflect the impairment of certain aircraft. The impairment charges are reflected in Other expenses in the Company's consolidated statements of income. The results of the aircraft financing business are included in the Company's Institutional Securities business segment (see Note 17).

In accordance with SFAS No. 121, the Company tested each of its aircraft for impairment by comparing each aircraft's projected undiscounted cash flows to its respective carrying value. For each aircraft for which impairment was indicated, the Company adjusted the carrying value of each aircraft to its fair value, if lower than carrying value. The Company determined the amount of the charge for each impaired aircraft using "base value" estimates provided by independent appraisal companies (BK Associates, Inc., Morten Beyer & Agnew Inc. and Airclaims Limited). Going forward, the Company has determined to use "market value" estimates provided by one or more independent appraisers to estimate fair value for its aircraft if impairment is indicated. For the aircraft subject to prior impairment charges, the Company's use of "market value" estimates rather than "base value" estimates would not have resulted in a material change to the Company's consolidated results of operations.

The current market environment is characterized by distressed sellers and extremely limited sales activity. If the Company chose to liquidate its entire fleet at this time, which is not currently contemplated, the Company believes that given these distressed market conditions, it could be forced to accept values that are substantially, perhaps 20% to 30%, lower than the carrying value of its aircraft assets. These assets are recorded on the Company's consolidated statements of financial condition as Aircraft under operating leases. The Company has not recorded an impairment charge of this magnitude because the majority of the individual aircrafts' undiscounted cash flows exceeded their respective carrying values, and, therefore, impairment was not indicated for each aircraft under SFAS No. 121.

20. Terrorist Attacks.

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.

The Company has recognized costs related to the terrorist attacks, which have been offset by an expected insurance recovery. These costs and the related expected insurance recovery pertain to 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, and other business recovery costs. Such costs amounted to $89 million for fiscal 2002 and $56 million for fiscal 2001.

21. Restructuring and Other Charges.

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

This charge, which is recorded as Restructuring and other charges on the Company's consolidated statements of income, consisted of space-related costs of $162 million and severance-related costs of $73 million. The space-related costs were attributable to the closure or subletting of excess office space, primarily in the U.S. and the U.K., as well as the Company's decision to consolidate its Individual Investor Group branch locations. The majority of the space-related costs consisted of rental charges and the write-off of furniture, fixtures and other fixed assets at the affected office locations. The severance-related costs were attributable to workforce reductions. The Company reduced the number of its employees by approximately 2,200 during the fourth quarter of fiscal 2002, primarily in the Institutional Securities and Individual Investor Group businesses. The majority of the severance-related costs consisted of severance payments and outplacement costs provided to the affected individuals. The restructuring and other charges were included in the Institutional Securities ($117 million), Individual Investor Group ($112 million) and Investment Management ($6 million) business segments.

22. Quarterly Results (unaudited).

	2002 Fiscal Quarter				2001 Fiscal Quarter(1)			
	First	Second	Third	Fourth	First	Second	Third	Fourth
	(dollars in millions, except share and per share data)							
Total revenues	$ 8,540	$ 8,149	$ 8,156	$ 7,570	$ 12,681	$ 12,605	$ 10,332	$ 8,256
Interest expense	2,936	2,844	3,188	3,002	6,172	6,406	4,869	3,282
Provision for consumer loan losses	345	340	332	319	213	231	277	331
Net revenues	5,259	4,965	4,636	4,249	6,296	5,968	5,186	4,643
Total non-interest expenses	3,912	3,718	3,667	3,092	4,596	4,496	4,014	3,253
Income before income taxes, dividends on preferred securities subject to mandatory redemption, extraordinary item and cumulative effect of accounting change	1,347	1,247	969	1,157	1,700	1,472	1,172	1,390
Provision for income taxes	477	428	337	403	618	535	423	498
Dividends on preferred securities subject to mandatory redemption	22	22	21	22	7	7	14	22
Income before extraordinary item and cumulative effect of accounting change	848	797	611	732	1,075	930	735	870
Extraordinary item	—	—	—	—	—	—	(30)	—
Cumulative effect of accounting change	—	—	—	—	(59)	—	—	—
Net income	$ 848	$ 797	$ 611	$ 732	$ 1,016	$ 930	$ 705	$ 870
Earnings per share(2):								
Basic before extraordinary item and cumulative effect of accounting change	$ 0.78	$ 0.73	$ 0.57	$ 0.68	$ 0.98	$ 0.85	$ 0.67	$ 0.80
Extraordinary item	—	—	—	—	—	—	(0.03)	—
Cumulative effect of accounting change	—	—	—	—	(0.05)	—	—	—
Basic	$ 0.78	$ 0.73	$ 0.57	$ 0.68	$ 0.93	$ 0.85	$ 0.64	$ 0.80
Diluted before extraordinary item and cumulative effect of accounting change	$ 0.76	$ 0.72	$ 0.55	$ 0.67	$ 0.94	$ 0.82	$ 0.65	$ 0.78
Extraordinary item	—	—	—	—	—	—	(0.03)	—
Cumulative effect of accounting change	—	—	—	—	(0.05)	—	—	—
Diluted	$ 0.76	$ 0.72	$ 0.55	$ 0.67	$ 0.89	$ 0.82	$ 0.62	$ 0.78
Dividends to common shareholders	$ 0.23	$ 0.23	$ 0.23	$ 0.23	$ 0.23	$ 0.23	$ 0.23	$ 0.23
Book value	$ 18.97	$ 19.39	$ 19.59	$ 20.24	$ 17.23	$ 17.54	$ 17.76	$ 18.64
Stock price range(3)	$46.63-59.64	$44.64-57.88	$35.60-46.38	$29.31-46.40	$62.38-89.80	$45.26-74.26	$51.20-66.10	$37.62-59.52

(1) Certain reclassifications have been made to previously reported fiscal 2001 quarterly amounts.

(2) Summation of the quarters' earnings per common share may not equal the annual amounts due to the averaging effect of the number of shares and share equivalents throughout the year.

(3) Amounts represent the range of closing prices per share on the New York Stock Exchange for the periods indicated. The number of shareholders of record at November 30, 2002 approximated 141,000. The number of beneficial owners of common stock is believed to exceed this number.