

John Mack, Chairman and Chief Executive Officer

David H. Sidwell, Chief Financial Officer

David W. Nelms, Chairman & CEO, Discover Financial Services

August 17, 2005

# Notice

The information provided herein may include certain non-GAAP financial measures. The reconciliation of such measures to the comparable GAAP figures are included in the Company's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on 8-K, including any amendments thereto, which are available on [www.morganstanley.com](http://www.morganstanley.com).

This presentation may contain forward-looking statements. You are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date on which they are made, which reflect management's current estimates, projections, expectations or beliefs and which are subject to risks and uncertainties that may cause actual results to differ materially. In particular, the Company's ability to effect a sale of the Company's aircraft leasing business, to realize the full extent of cost savings or benefits from such sale and to assure that subsequent developments (including the ultimate structure, pricing and timing of the transaction) do not cause actual charges to exceed the currently estimated charges to be incurred in the transaction may cause actual results to differ materially from the Company's current estimates, projections, expectations or beliefs. In addition, the future performance of Discover Financial Services is subject to numerous risks impacting the credit card industry that may cause actual results to differ materially from the Company's current estimates, projections and beliefs, including: rising cost of funds pressuring spreads; slow industry growth with rising payment rates; future loan loss rate uncertainty, especially given bankruptcy reform and changing minimum payment requirements; and a consolidating industry with competitive pressures and increasing marketing constraints. For a discussion of additional risks and uncertainties that may affect the future results of the Company, please see "Forward-Looking Statements" immediately preceding Part I, Item 1, "Competition" and "Regulation" in Part I, Item 1 and "Certain Factors Affecting Results of Operations" in Part II, Item 7 of the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2004 and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Quarterly Reports on Form 10-Q for the quarterly periods ended February 28, 2005 and May 31, 2005 and in other items throughout the Form 10-K and Forms 10-Q.

# Agenda

- Introduction
- Initial Actions
- Discover opportunities
- Q&A
- Appendix

# Introduction

# Morgan Stanley Strategic Direction

## GOAL

To be the clear leader in offering premier, innovative service to clients, while delivering superior returns to shareholders

- Relentless focus on improving profit margins, growth and return on equity
- Sharpen focus on serving clients
- Operate with sufficient scale and flexibility to compete in a fast-changing and competitive marketplace
- Use capital as efficiently as possible, while continuing to focus on managing risk
- Create a more cohesive culture by reducing bureaucracy and eliminating insular silos

# Initial Actions

- Retain Discover to create value for shareholders
- Exit non-core aircraft leasing business
- New management and new initiatives in Retail Brokerage business
- Appoint new Directors

# Discover Potential Spin-Off Evaluation Process

- In April, Board authorized exploration of potential Discover spin-off
- Investment Banking team and management subsequently performed significant analysis
  - Determination of capital structure
  - Financial projections of spin-off vs. subsidiary
  - Rating agency discussions
  - Valuations
- A number of market changes occurred during this process
  - MBNA profit shortfall and subsequent announced sale to Bank of America
  - Provident announced sale to Washington Mutual
  - Rating agency actions
  - Multiple new lawsuits of merchants vs. Visa and MasterCard
- Discover trends were also taken into account
  - Retail sales growth
  - Declining delinquency rates
  - Signed China UnionPay deal
- After careful consideration, conclusion was that it was in shareholders' best interests to retain Discover

# Benefits of Retaining Discover

- Earnings diversification
  - Strong ROE and capital generation
  - Reduced volatility
- Broader capital base
- Financial synergies
  - Lower funding costs
  - Shared corporate functions
- Enhanced Discover growth prospects post-DOJ suit
  - Payments opportunities (PULSE debit network, GE/Wal-Mart, China UnionPay)
  - Stronger network potential to drive higher Discover Card growth and profits
  - Discover independence not required to pursue new growth options
- Discover is a unique franchise
  - Strong brand, #1 rewards program
  - Large, loyal, high quality customer base



# Aircraft Leasing Divestiture Evaluation Process

- AWAS remains non-core to Morgan Stanley
  - Without viable exit alternatives, AWAS was retained through period of unprecedented decline in aircraft industry following September 11
  - Significant concentration in aircraft asset class has inhibited investment in other Morgan Stanley activities
  - Proceeds from the sale of AWAS could be deployed more profitably in core businesses
- Recently, the operating environment in aircraft leasing has improved
  - Higher lease rates and lease activity
  - AWAS currently has positive momentum
- The market for aircraft businesses has become more active
  - For the first time since 2001, there have been acquisitions of other operating lessors
  - Morgan Stanley has recently received expressions of interest from several credible potential acquirers of AWAS
- We will take an estimated after-tax non-cash charge in 3Q05 of approximately \$1Bn to write down the value of the business to its estimated market value

# Aircraft Leasing Business Snapshot

- Third largest aircraft lessor
  - 155 planes, 4 engines
  - Average age of 12.1 years
- Expertise in aircraft trading and lease remarketing
- Geographically diverse – 75 customers in 45 countries
- Improving lease rates
- No planes on the ground
- Book value of aircraft \$3.7Bn

# Retail Brokerage: New management, new initiatives

## **New management:**

- James P. Gorman hired as new President and Chief Operating Officer of the Individual Investor Group
  - Brings unmatched breadth and depth of experience
  - Record of successfully building retail financial services businesses
- Uniquely qualified to lead the transformation of Morgan Stanley's retail brokerage business
- Assumes new role effective February 2006

## **New initiatives:**

- Reducing number of new financial advisor trainees hired in 2006 to 1,000 vs. 2005 class of 2,400
- Cut the bottom 10% of financial advisors in terms of production
- Stepping up efforts to recruit proven, experienced financial advisors who are focused on serving high-net-worth individuals
- Working to generate new revenue streams, including banking/deposits
- Close the margin gap with our peers within the next 2–3 years

# New Additions to the Board of Directors

- Three new directors
  - **Roy J. Bostock**
    - Former Chairman of B|Com3 Group, one of the world's leading advertising agencies
  - **Charles H. Noski**
    - Former senior executive of Northrop Grumman, AT&T and Hughes Electronics
  - **O. Griffith Sexton**
    - Economics and finance professor at Columbia Business School
    - Long-time investment banker
- Number of independent directors increases from 10 to 12
- Elections effective September 15

# Discover Opportunities

# Discover Profile



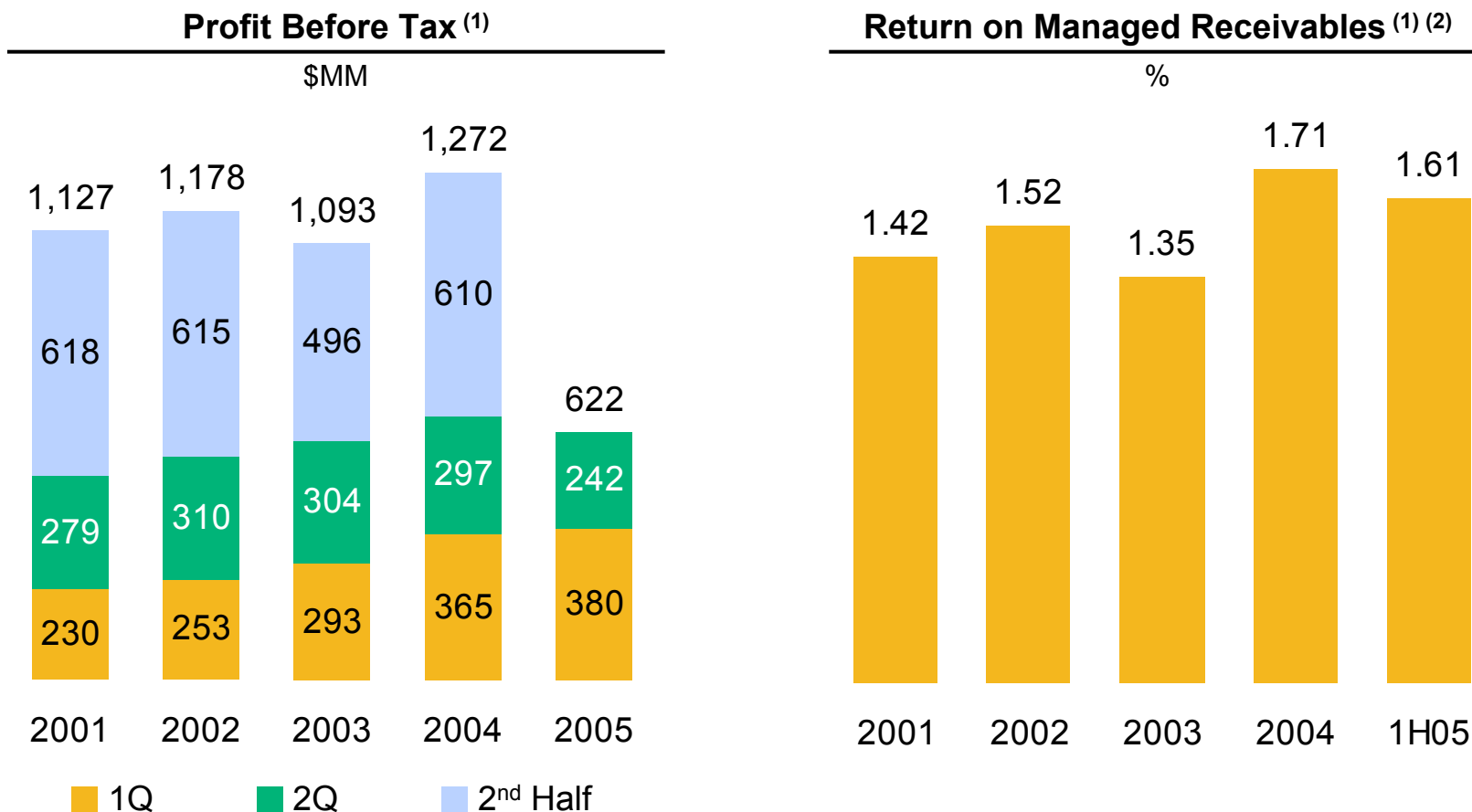
- 50MM+ cardmembers, \$47Bn managed credit card loans
- 4MM+ merchants and cash access locations
- Record \$1.3Bn PBT in 2004<sup>(1)</sup> (ROE in excess of 19%<sup>(2)</sup>), consistent earnings and capital generation (cumulative net income of \$3.7Bn over past 5 years)
- America's #1 cash rewards program – Cashback Bonus®
- One of the strongest brands in financial services
- Recent court ruling allows new partnerships with financial institutions
  - Acquisition of PULSE: entry into rapidly growing debit market
  - GE/Wal-Mart contract: first major third-party credit issuer on Discover® Network
  - China UnionPay reciprocal acceptance agreement
- Growing U.K. business with 1.4MM accounts and \$2.5Bn managed loans since 1999 launch

Source: Morgan Stanley

Notes: (1) Includes Mortgage Lending business scheduled to be transferred to Institutional Securities in 3Q05. Mortgage Lending business had PBT of \$51 MM in 2004.

(2) Average equity represents 1/12 of average managed net consumer loans, which equals \$4.0 Bn for 2004. (PULSE transaction, which added approximately \$300 MM in capital, closed in January 2005.)

# Consistent Profits and Returns



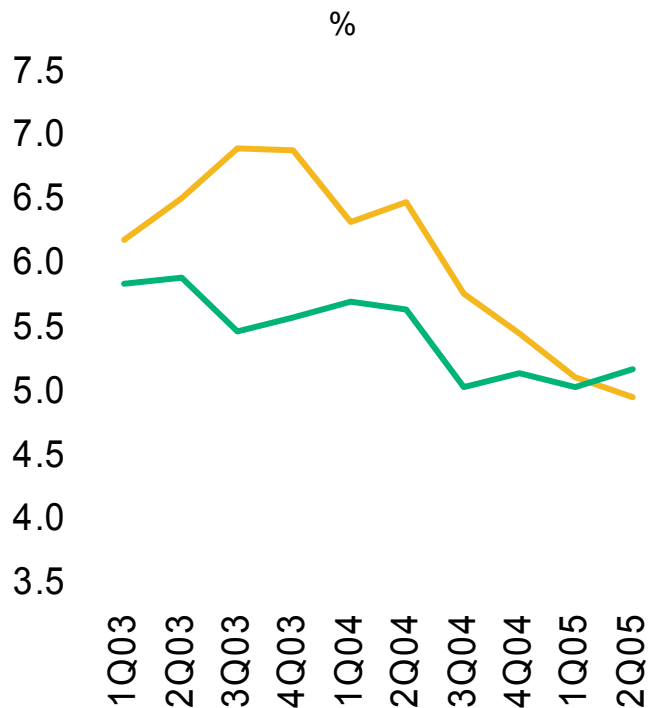
Source: Morgan Stanley

Notes: (1) Includes Mortgage Lending business scheduled to be transferred to Institutional Securities in 3Q05. Mortgage Lending business had PBT of \$51 MM in 2004.

(2) Return on managed receivables calculated by net income divided by average managed credit card receivables.

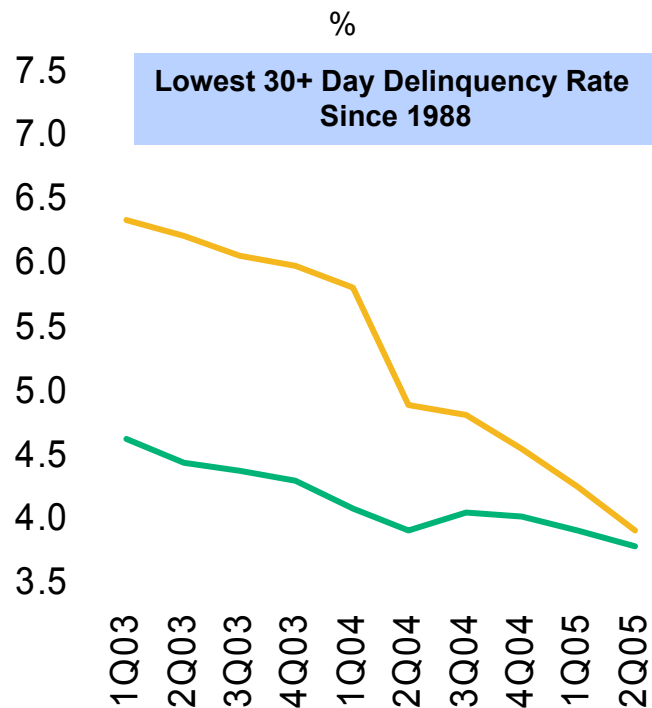
# Step Change Improvement in Credit Risk Profile

## Charge-off Rate (Managed)



— Discover (Fiscal Yr) — Top 5 Issuers (Calendar Yr) <sup>(1)</sup>

## 30+ Day Delinquency Rate (Managed)



— Discover (Fiscal Yr) — Top 4 Issuers (Calendar Yr) <sup>(2)</sup>

Source: Morgan Stanley

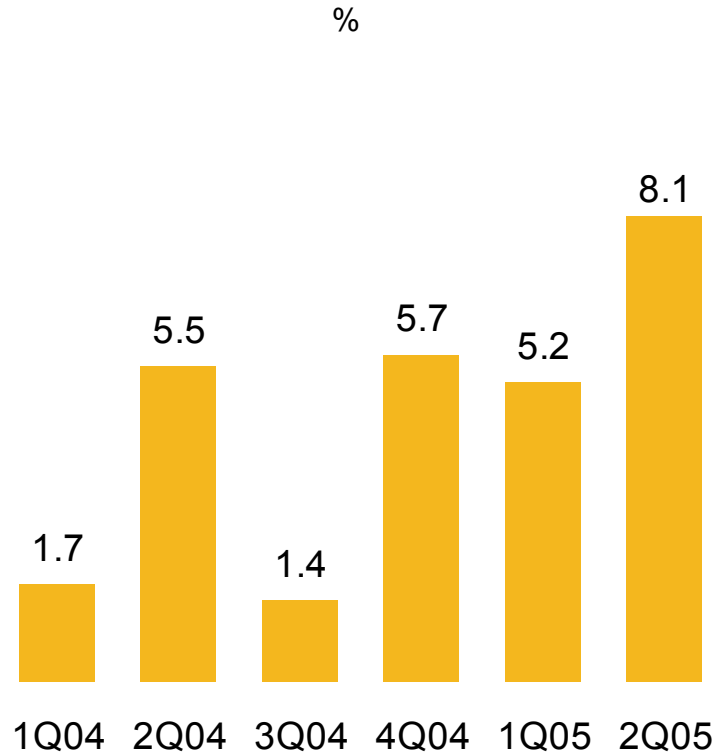
Notes: (1) Top 5 issuer charge-off rates are derived using a weighted average of loss rates from competitor quarterly earnings releases. Competitors included are Bank of America, Capital One (US Cards), Chase, Citigroup (NA Cards), and MBNA (Credit Cards)

(2) Top 4 issuers delinquency rates are derived using a weighted average of delinquency rates from competitor quarterly earnings releases. Competitors included are Bank of America, Capital One (US Cards), Chase, and MBNA (Credit Cards). Citigroup does not report 30+ day delinquency.

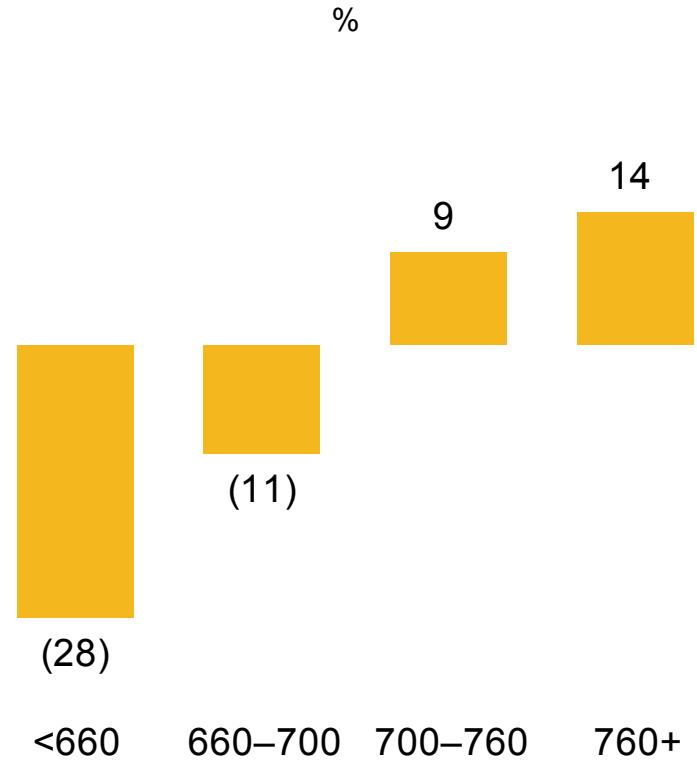


# Attractive Discover Growth Trends

**Discover Sales Growth (Year/Year) <sup>(1)</sup>**



**Change in U.S. Credit Card Receivables by FICO Score (2Q05 vs. 2Q03)**

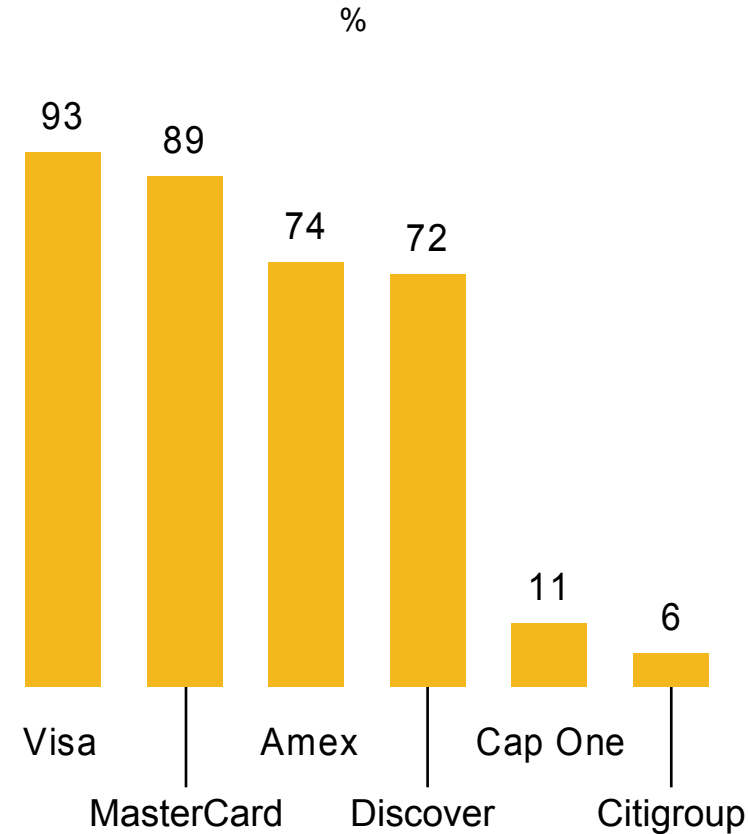


Source: Morgan Stanley

Note: (1) Sales represent U.S. and U.K. cardholder purchase dollar volume net of returns

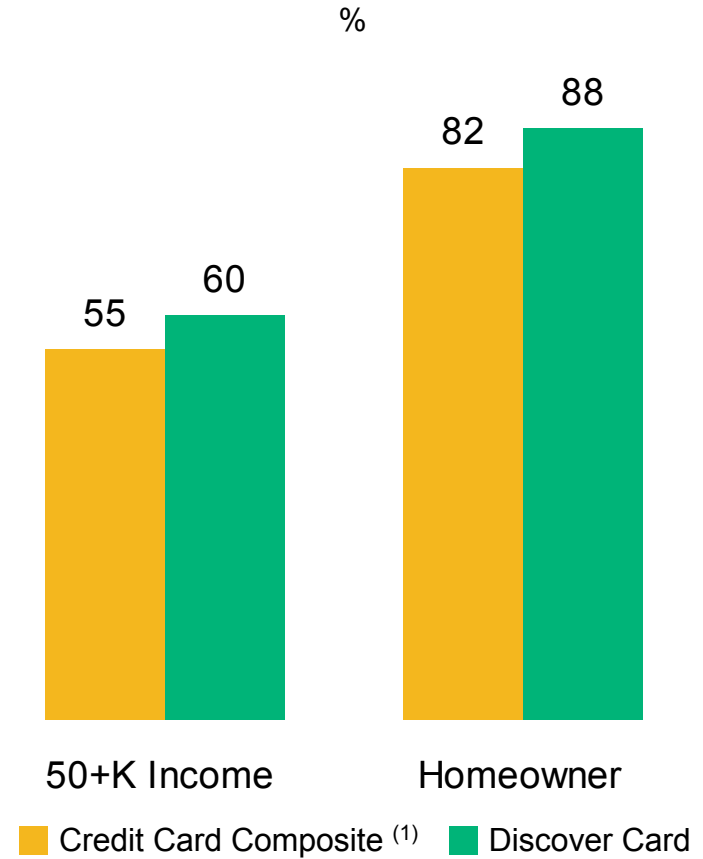
# Discover Has Leading Brand and Attractive Customer Profile

**Credit Card Brand Unaided Awareness  
December 2004 Survey**



Source: C&R Research, December 2004 (Discover Proprietary Research)

**Discover Card Customer Profile**

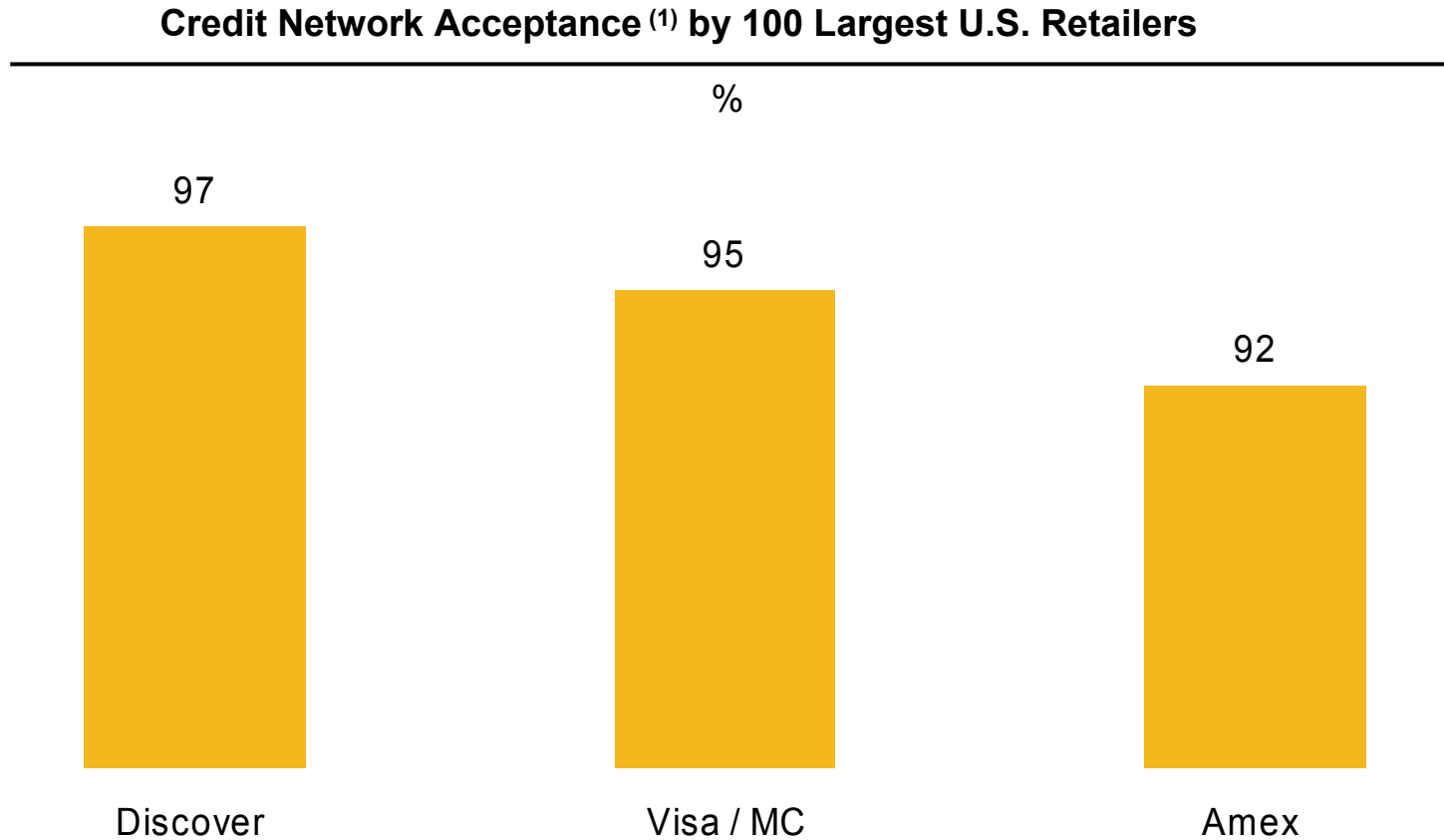


Source: Taylor Nelson Sofres (TNS) Global – 2004 Consumer Card Strategies Research Program  
 Note: (1) Represents survey respondents indicating that they hold any general purpose credit card

# Discover Card's *Cashback Bonus* Is America's #1 Cash Rewards Program

- Industry's largest cash rewards program
  - 50MM Cardmember base
  - \$550MM cash rewards earned in 2004
- Leading structure
  - Up to 1% earnings with no expiration
  - Full 5% on Get More purchases
  - 50 Cashback Bonus partners
  - Highly flexible redemption
- Loyalty advantage
  - Low attrition rate
  - Winner of Brand Key Customer Loyalty award past 7 years

# Acceptance Leadership With Largest Merchants



Source: Top 100 U.S. retailers from Triversity ([www.stores.org](http://www.stores.org))

Note: (1) Chart reflects Discover estimate of credit network acceptance at majority of in-store POS locations. Wal-Mart and Sam's Club counted as two separate merchants

# Third Party Issuers Are Being Signed

4Q04 DOJ suit conclusion allows Discover to sign third party financial institution issuers

- Over 2MM cards issued
- 7 third party issuers to date

## Consumer and Business Credit Cards



## Mall Cards

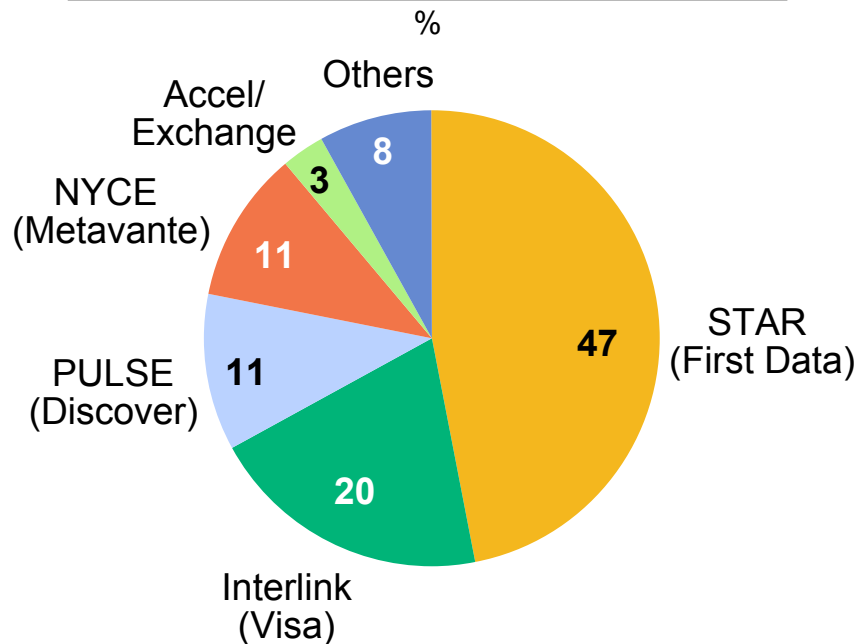


## Experiential Cards



# Addition of PULSE Debit Network Broadens Product Set and Customer Base

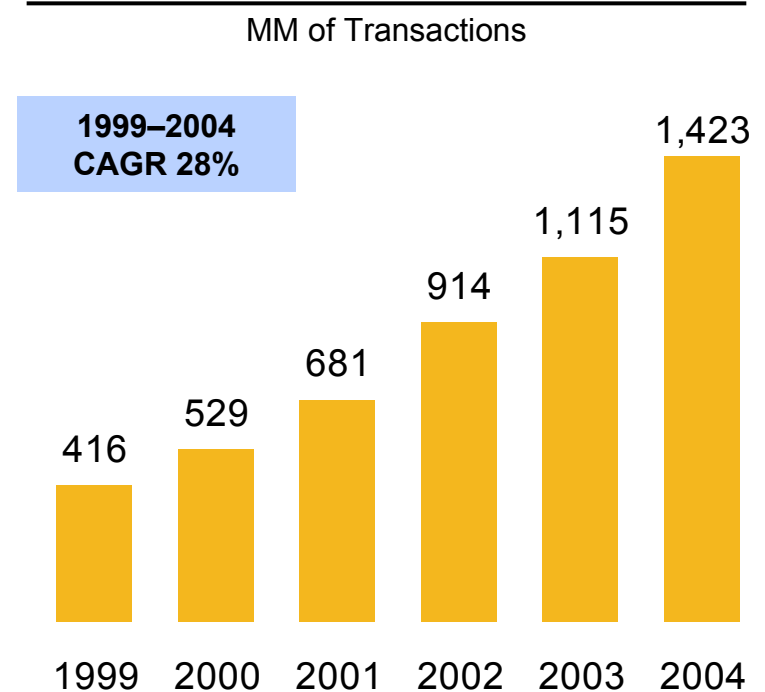
**PIN Debit Market Share**



- PULSE acquisition closed 1/05
- Over 4,100 financial institution customers

Source: ATM & Debit News (9/16/04) – Survey as of March 2004

**PULSE Transactions**



Source: Company Data

# China UnionPay Agreement – Greater Acceptance and Volume

- Agreement signed May 2005
  - Long term
  - Exclusive component
- Provides acceptance in China through largest domestic network
  - 130+ bank issuers
  - 400,000+ merchants
  - 60,000+ ATMs
  - Approximately 3 times greater acceptance in China versus Visa / MasterCard
- Generates incremental volume on our PULSE Network
  - Possible extension to Discover Network
  - China UnionPay has 800MM cards

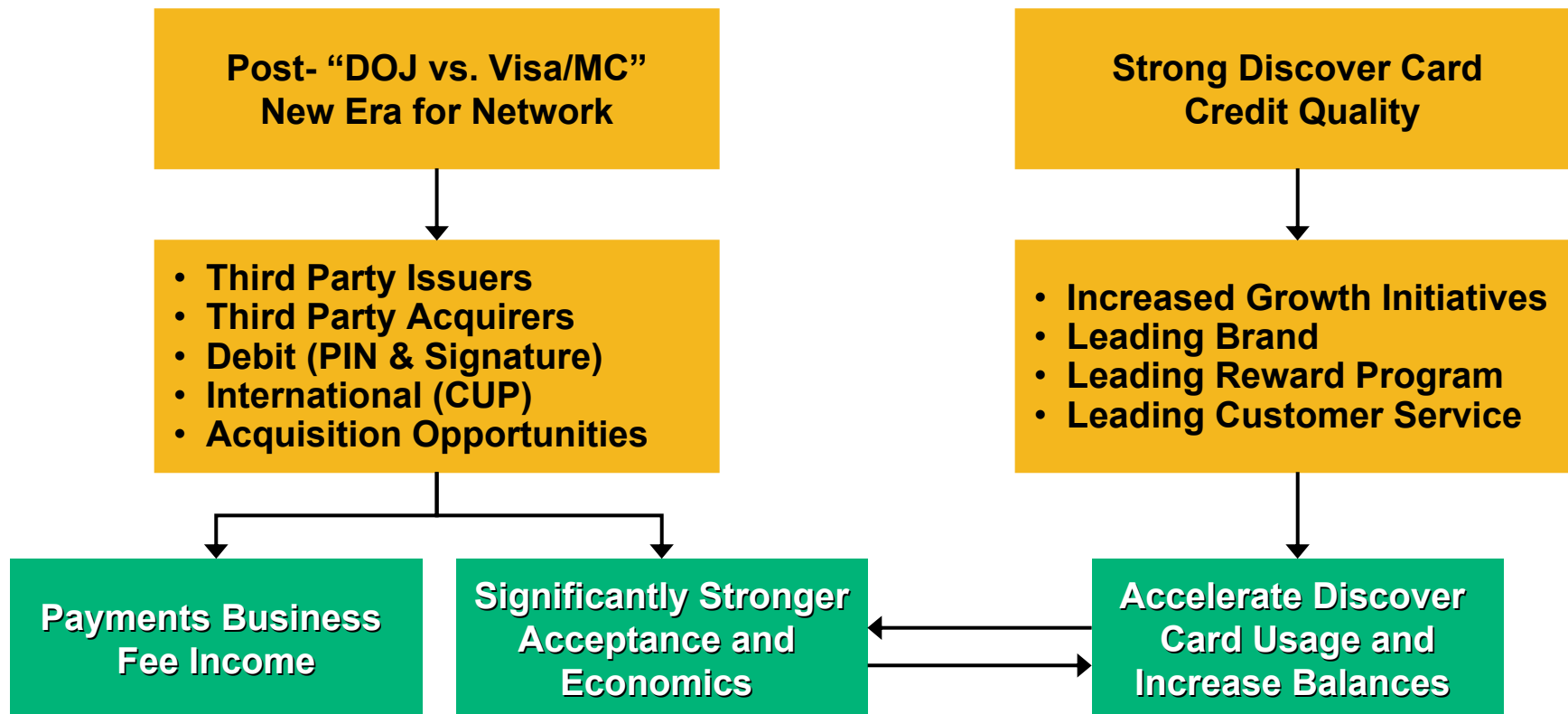


# Current Credit Card Industry Risks

- Rising cost of funds pressuring spreads
- Slow industry loan growth / rising payment rates
- Future loan loss rate uncertainty, especially given bankruptcy reform and changing minimum payment requirements
- Consolidating industry / competitive pressures
- Increasing marketing constraints (including opt-out lists)

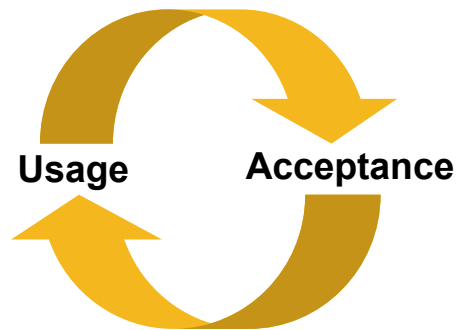


# New Era for Discover Financial Services



# Discover Financial Services Strategy

- Deliver sustained growth in revenues and profits by promoting the virtuous circle of merchant acceptance and cardmember usage
  - Increasing Discover Card usage and credit balances, leveraging our #1 cash rewards program, top-rated customer service, and leading brand
  - Maintaining and capitalizing on strong credit quality and a more loyal, attractive cardmember base
  - Enhancing merchant acceptance and the economics of Discover and PULSE Networks
  - Attracting third-party issuers to the Discover and PULSE Networks, such as GE consumer finance and Wal-Mart/Sams's Club
  - Expanding our international operations



# Q&A

# Appendix

# Implications of AWAS Divestiture

## Accounting

- Aircraft business will be classified as Held for Sale in 3Q05
- Results of operations for Held for Sale assets and liabilities will be reported as discontinued operation (prior periods will be restated)
- After-tax loss currently estimated at \$1.0Bn
- Assets and liabilities of aircraft business would be recorded at fair value
- Appraised values of the portfolio of aircraft represent a summation of each of the estimated values of the aircraft assuming each aircraft is sold individually
  - Appraisal values received in August 2005
  - Range of \$2.5Bn to \$3.3Bn; average \$2.8Bn
- Appraisal values do not consider:
  - Ongoing costs of running the business
  - Long-term prospects of the business as a whole
  - Divestiture of a large number of planes at one time
- Estimated value of the business based on:
  - Evaluation of current market conditions
  - Recent transactions involving the sales of similar aircraft leasing businesses
  - Detailed assessment of the portfolio
  - Additional valuation analysis

## Capital/Regulatory

- The Firm's capital adequacy objectives (economic capital requirements and leverage considerations) continue to be met

# Retail Brokerage Business: Client Segmentation

## Retail Brokerage Assets by Client Segment (\$Bn)

	1Q04	2Q04	3Q04	4Q04	1Q05	2Q05	% Change 2Q05/2Q04
\$10MM or more	111	106	105	111	117	117	11
\$1MM – \$10MM	173	167	174	188	196	196	17
\$100K – \$1MM	194	190	186	188	186	184	(3)
< \$100K	45	43	40	39	37	35	(18)
Total	523	506	505	526	536	532	5
International	48	48	46	50	55	54	12
Small Business Accounts	24	25	25	26	27	27	10
Total Client Assets	595	579	576	602	618	613	6

Source: Morgan Stanley

Note: Segmentation analysis includes retail broad-based branch system and U.S. UHNW client assets

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