Morgan Stanley & Co. Incorporated

CONSOLIDATED STATEMENT OF FINANCIAL CONDITION

(Unaudited)

May 31, 2003

Morgan Stanley

Investments and services are offered through Morgan Stanley & Co. Incorporated

Morgan Stanley & Co. Incorporated

Consolidated Statement of Financial Condition (Unaudited)

(In thousands of dollars, except share data)	May 31, 2003
Assets	
Cash and cash equivalents	$ 180,098
Cash and securities deposited with clearing organizations or segregated under federal and other regulations (including securities at fair value of $22,760,560)	28,415,600
Financial instruments owned ($22,658,093 was pledged to various parties):	
U.S. government and federal agency	15,125,184
Corporate and other debt	18,852,499
Corporate equities	8,107,185
Derivative contracts	4,186,802
Securities purchased under agreements to resell	43,343,721
Securities received as collateral	18,291,796
Securities borrowed	133,686,583
Receivables:	
Customers	10,888,288
Brokers, dealers and clearing organizations	2,954,374
Interest and dividends	642,464
Fees and other	884,149
Property, equipment and leasehold improvements, at cost (less accumulated depreciation and amortization of $153,459)	93,333
Other assets	214,716
Total assets	$285,866,792
Liabilities and Stockholder's Equity	
Short-term borrowings:	
Affiliates	$ 13,603,760
Other	570,541
Financial instruments sold, not yet purchased:	
U.S. government and federal agency	8,733,646
Corporate and other debt	4,626,106
Corporate equities	5,450,561
Derivative contracts	5,037,074
Securities sold under agreements to repurchase	80,224,296
Obligation to return securities received as collateral	18,291,796
Securities loaned	67,396,954
Payables:	
Customers	60,753,069
Brokers, dealers and clearing organizations	8,780,071
Interest and dividends	831,216
Other liabilities and accrued expenses	2,720,189
	$277,019,279
Subordinated liabilities	4,049,500
Stockholder's equity:	
Common stock ($25 par value, 1,000 shares authorized, issued and outstanding)	25
Paid-in capital	260,922
Retained earnings	4,537,066
Total stockholder's equity	4,798,013
Total liabilities and stockholder's equity	$285,866,792

See Notes to Consolidated Statement of Financial Condition.

Notes to Consolidated Statement of Financial Condition (Unaudited)

(In thousands of dollars, except where noted) **May 31, 2003**

NOTE 1 - Introduction and Basis of Presentation

The Company

Morgan Stanley & Co. Incorporated, together with its wholly owned subsidiaries, (the "Company") provides a wide range of financial and securities services. Its businesses include 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. The Company's services are provided to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

The consolidated statement of financial condition includes the accounts of Morgan Stanley & Co. Incorporated ("MS&Co.") and its wholly owned subsidiaries. MS&Co. and certain of its subsidiaries are registered with the Securities and Exchange Commission ("SEC") as broker-dealers. MS&Co. is also registered as a futures commission merchant with the Commodity Futures Trading Commission ("CFTC"). The Company is a wholly owned subsidiary of Morgan Stanley (the "Parent"), formerly named Morgan Stanley Dean Witter & Co.

Basis of Financial Information

All material intercompany accounts and transactions have been eliminated in consolidation.

The consolidated statement of financial condition is prepared in accordance with accounting principles generally accepted in the U.S., which require the Company to make estimates and assumptions regarding the valuation of certain financial instruments, the potential outcome of litigation and other matters that affect the consolidated statement of financial condition and related disclosures. The Company believes that the estimates utilized in the preparation of the consolidated statement of financial condition are prudent and reasonable. Actual results could differ materially from these estimates.

Related Party Transactions

The Company has transactions with the Parent and its affiliates, including leasing arrangements, the performance of administrative services and the execution of securities transactions with and on behalf of affiliates.

Receivables from affiliated companies as of May 31, 2003 are comprised of:

Securities purchased under agreements to resell ("reverse repurchase agreements")	$30,835,948
Securities borrowed	20,620,596
Brokers, dealers and clearing organizations	1,345,181
Customers	119,004
Interest and dividends	162,711
Fees and other	96,821
	$53,180,261

Payables to affiliated companies as of May 31, 2003 are comprised of:

Securities loaned	$31,548,675
Securities sold under agreements to repurchase ("repurchase agreements")	12,060,586
Brokers, dealers and clearing organizations	5,005,634
Customers	1,716,907
Interest and dividends	426,106
Other liabilities and accrued expenses	82,048
	$50,839,956

NOTE 2 - Summary of Significant Accounting Policies

Financial Instruments Used for Trading

Financial instruments owned and financial instruments sold, not yet purchased, which include cash and derivative products (futures, forwards and options), used in the Company's trading activities 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 liquidation sale. A substantial percentage of the fair value of the Company's financial instruments owned and financial instruments sold is based on observable market prices, observable market parameters, or is derived directly 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.

Purchases and sales of financial instruments are recorded in the accounts on trade date. Unrealized gains and losses arising from the Company's dealings in over-the-counter ("OTC") financial instruments, including derivative contracts related to financial instruments, are presented in the accompanying consolidated statement of financial condition on a net-by-counterparty basis, where appropriate.

Property, Equipment and Leasehold Improvements
Property and equipment are depreciated on a straight-line basis over the estimated useful lives of the related assets, while leasehold improvements are amortized on a straight-line basis over the lesser of the economic useful life of the asset or, where applicable, the remaining term of the lease.

Customer Transactions
Customers' securities transactions are recorded on a settlement date basis with related commission revenues and expenses recorded on trade date basis.

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 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.

Foreign Currency Transactions
Non-U.S. dollar denominated assets and liabilities are translated at period end rates of exchange.

Securitization Activities
The Company engages in securitization activities related to corporate, commercial and U.S. agency collateralized mortgage loans, municipal bonds and other types of financial assets. The Company may retain interests in the securitized financial assets as one or more tranches of the securitization and rights to any excess cash flows remaining after payments to investors in the securitization trusts of their contractual rate of return. The exposure to credit losses from securitized loans is limited to the Company's retained interest in securitized loans. 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 allocated between the assets sold and the retained interests based upon their respective fair values at the date of sale. To obtain fair values, quoted market prices are used if available. However, quoted 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.

Guarantees
In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," which requires the Company to disclose information about its obligations under certain guarantee arrangements. FIN 45 defines guarantees as contracts and indemnification agreements that contingently require a guarantor to make payments to the guaranteed party based on changes in an underlying (such as an interest or foreign exchange rate, security or commodity price, an index or the occurrence or nonoccurrence of a specified event) related to an asset, liability or equity security of a guaranteed party. FIN 45 also defines guarantees as contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an agreement as well as indirect guarantees of the indebtedness of others. There was no change in the amount of liability recognized for non-derivative guarantees issued or modified after December 31, 2002 as a result of the adoption of FIN 45.

Under FIN 45, certain derivative contracts meet the accounting definition of a guarantee, including certain written options and contingent forward contracts. Although the Company's derivative arrangements do not specifically identify whether the derivative counterparty retains the underlying asset, liability or equity security, the Company has disclosed information regarding all derivative contracts that could meet the FIN 45 definition of a guarantee. In order to provide information regarding the maximum potential amount of future payments that the Company could be required to make under certain derivative contracts, the notional amount of the contracts has been disclosed.

The Company does not monitor its risk exposure to such derivative contracts based on derivative notional amounts; rather the Company manages its risk exposure on a fair value basis. Aggregate market risk limits have been established and market risk measures are routinely monitored against these limits. The Company also manages its exposure to these derivative contracts through a variety of risk mitigation strategies including, but not limited to, entering into offsetting economic hedge positions. The Company records all derivative contracts on its consolidated statement of financial condition at fair value and believes that the notional amounts of the derivative contracts generally overstate its exposure. For further discussion of the Company's derivative risk management activities see Note 7 to the Company's consolidated statement of financial condition.

In connection with a funding transaction, the Company provides a guarantee to a third party of its affiliate's contractual obligation to repay. The Company has the ability to offset any amount it is required to pay under the guarantee with an obligation owed to its affiliate's parent.

The table below summarizes certain information regarding these guarantees at May 31, 2003:

	Maximum Potential Payout/Notional					Carrying
Type of	Years to Maturity				Total	Amount
Guarantee	Less than 1	1-3	3-5	Over 5		
Derivative contracts	$10,136,296	$329,126	$ -	$ -	$10,465,422	$394,024
Financial guarantee	-	-	-	$409,690	$ 409,690	-

The Company is a member of various U.S. exchanges and clearinghouses that trade and clear securities and/or futures contracts. Associated with its membership, the Company may be required to pay a proportionate share of the financial obligations of another member who may default on its obligations to the exchange or the clearinghouse. While the rules governing different exchange or clearinghouse memberships vary, in general the Company's guarantee obligations would arise only if the exchange or clearinghouse had previously exhausted its resources. In addition, any such guarantee obligation would be apportioned among the other non-defaulting members of the exchange or clearinghouse. Any potential contingent liability under these membership agreements cannot be estimated. The Company has not recorded any contingent liability in the consolidated statement of financial condition for these agreements and believes that any potential requirement to make payments under these agreements is remote.

Variable Interest Entities

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities – an interpretation of ARB No. 51," which 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. Under FIN 46, 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 had acquired before February 1, 2003. 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 or bond obligations). The Company engages in these transactions principally 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), the Company does not consolidate the entity.

At May 31, 2003, the aggregate size of the VIEs for which the Company holds significant variable interests, which were acquired after January 31, 2003 and consists of a subordinated beneficial interest, was approximately $303,500. The Company's variable interest associated with this collateralized debt obligation entity, was approximately $35,356, which represents the Company's maximum exposure to loss at May 31, 2003.

The Company believes that it is reasonably possible that it will either disclose information 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 May 31, 2003, 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 $300,500. The Company's variable interests associated with these entities, primarily collateralized debt and bond obligation entities, was approximately $33,122, which represents the Company's maximum exposure to loss at May 31, 2003. The Company hedges the risks inherent in its variable interest holdings thereby reducing its exposure to loss. The Company's maximum exposure to loss does not include the offsetting benefit of any financial instruments that the Company utilizes to hedge these risks.

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 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..

NOTE 3 -
Securities Financing and Securitization Transactions

Reverse repurchase agreements and repurchase agreements, principally U.S. government and federal 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 and repurchase agreements are presented on a net-by-counterparty basis, where appropriate. It is the Company's policy to take possession of securities purchased under agreements to resell. Securities borrowed and securities loaned are also 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 financing. 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 statement of financial condition. The carrying value and classification of securities owned by the Company that have been loaned or pledged to various parties where those parties do not have the right to sell or repledge the collateral were approximately:

	May 31, 2003
Financial instruments owned:	
U.S. government and federal agency	$ 7,365,000
Corporate and other debt	2,825,000
Corporate equities	3,194,000
Total	$13,384,000

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 federal agency securities, 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 the delivery to counterparties to cover short positions. At May 31, 2003, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was $298,710,797, and the fair value of the portion that has been sold or repledged was $281,012,223.

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.

The Company engages in securitization activities and may act as underwriter of the beneficial interests issued by the securitization vehicle. 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 statement of financial condition at fair value. Retained interests in securitized financial assets were approximately $1,297,407 at May 31, 2003, the majority of which were related to residential mortgage loan and U.S. agency collateralized mortgage loan securitization transactions. The assumptions that the Company used to determine the fair value of its retained interests at the time of securitization related to those transactions that occurred during the six months ended May 31, 2003 were not materially different from the assumptions included in the table below.

The following table presents information on the Company's residential mortgage loan and U.S. agency collateralized mortgage loan securitization transactions. Key economic assumptions and the sensitivity of the current fair value of the retained interests to immediate 10% and 20% adverse changes in those assumptions at May 31, 2003 were as follows:

	Residential mortgage loan	U.S. agency collateralized mortgage obligations
Retained interests (carrying amount/ fair value)	$315,388	$792,883
Weighted average life (in months)	8	38
Credit losses (rate per annum)	3.48%–4.81%	-
Impact on fair value of 10% adverse change	$(33)	-
Impact on fair value of 20% adverse change	$(66)	-
Weighted average discount rate (rate per annum)	11.39%	4.89%
Impact on fair value of 10% adverse change	$(2,193)	$(8,597)
Impact on fair value of 20% adverse change	$(4,352)	$(16,925)
Prepayment speed assumption	582-1900 PSA	343-1059 PSA
Impact on fair value of 10% adverse change	-	$(3,148)
Impact on fair value of 20% adverse change	-	$(5,916)

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 assumptions; in practice, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities. In addition, the sensitivity analysis does not consider any corrective action that the Company may take to mitigate the impact of any adverse changes in the key assumptions.

During the six month period ended May 31, 2003, the Company received $25,111,736 of proceeds from new securitization transactions and $2,050,429 of cash flows from retained interests in securitization transactions.

NOTE 4 -
Short-Term Borrowings

Borrowings from affiliates are unsecured, bear interest at prevailing market rates and are payable on demand. Other short-term borrowings consist of loans which are unsecured, generally bear interest at rates based upon the federal funds rate and are payable on demand.

The Company maintains a master collateral facility that enables it to pledge certain collateral to secure loan arrangements, letters of credit and other financial accommodations. As part of this facility, the Company 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 $1,800,000 for up to 364 days. This facility was renewed on May 22, 2003. At May 31, 2003, no borrowings were outstanding under this agreement.

The Company entered into a Revolving Credit facility dated September 28, 2001, in the amount of $100,000 for three years. At May 31, 2003, no borrowings were outstanding under this agreement.

These credit agreements contain restrictive covenants which require, among other things, that the Company maintain specified levels of consolidated stockholder's equity and Net Capital, as defined. As of May 31, 2003, the Company was in compliance with all restrictive covenants.

NOTE 5 -
Subordinated Liabilities

Subordinated liabilities consist of a Cash Subordination Agreement and a Subordinated Revolving Credit Agreement with the Parent and a Subordinated Indenture ("Indenture") with Bank One Trust Company, as trustee, dated September 12, 1994, and modified as of November 28, 1995 and April 24, 1997.

The Cash Subordination Agreement is for $2,500,000, bears interest at 6.55% per annum and has a maturity date of April 30, 2007. Additionally, $1,200,000 is payable under the Company's $5,000,000 Subordinated Revolving Credit Agreement which has a commitment termination date and maturity date of April 30, 2006 and April 30, 2007, respectively. Interest on this borrowing is payable at rates based upon the federal funds rate or the London Interbank Offered Rate.

The Indenture is comprised of the following:

Subordinated Notes	Maturity Date	Interest Rate	Amount
Series B	March 1, 2005	8.51%	$243,000
Series E	June 1, 2006	7.28%	81,500
Series F	June 1, 2016	7.82%	25,000
Total			$349,500

The estimated fair value of the Company's subordinated liabilities, based on rates available to the Company at May 31, 2003 for debt with similar terms and maturities, was approximately $4,442,000.

The Indenture contains restrictive covenants which require, among other things, that the Company maintain specified levels of Consolidated Tangible Net Worth and Net Capital, each as defined. As of May 31, 2003, the Company was in compliance with all restrictive covenants.

NOTE 6 -
Commitments and Contingencies

The Company has non-cancelable operating leases covering office space and equipment. At May 31, 2003, future minimum rental commitments under such leases were as follows:

Fiscal Year	Amount
2003	$ 48,508
2004	96,587
2005	91,653
2006	78,060
2007	55,851
Thereafter	287,152
Total	$657,811

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.

The Company had approximately $1,420,913 of letters of credit outstanding at May 31, 2003 to satisfy various collateral requirements.

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 statement of financial condition.

At May 31, 2003, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $14,027,917 and $5,779,792, respectively.

In the normal course of business, the Company has been named as a defendant in various legal actions, including arbitrations, arising in connection with its activities as a diversified financial services institution. Some of the legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. The Company is also involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies. Some of these legal actions, investigations and proceedings may result in adverse judgments, penalties or fines. 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 what the eventual loss or range of loss related to such matters will be. The Company believes, based on current knowledge and after consultation with counsel, that the outcome of such matters will not have a material adverse effect on the consolidated financial condition of the Company.

NOTE 7 -
Trading Activities

Trading

The Company's trading strategies rely on the integrated management of its client-driven and proprietary transactions, along with the hedging and financing of these positions. While 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 manages its trading businesses by product groupings and therefore has established distinct trading divisions having responsibility for equity and fixed income (including foreign exchange) products. Because of the integrated nature of the markets for such products, each product area trades cash instruments as well as related derivative products (e.g., options, futures and forwards with respect to such underlying instruments).

The Company's trading portfolios are managed with a view toward the risk and profitability of the portfolios to the Company. The nature of the equities and fixed income 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 exchange traded and OTC equity options and index futures. 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.

The counterparties to the Company's equity transactions include commercial banks, investment banks, broker-dealers, investment funds and industrial companies.

Fixed Income

The Company trades and makes markets in fixed income securities and related products, including preferred stock, investment grade corporate debt, high-yield securities, 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. In addition, the Company is a dealer in listed options on U.S. government bonds. The Company also takes positions in futures and options.

The Company also uses mortgage-backed forward agreements ("TBAs") in its role as a dealer in mortgage-backed securities and facilitates customer trades by taking positions in the TBA market. Typically, these positions are hedged by offsetting TBA contracts or underlying cash positions.

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 and forward 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, pound sterling, Swiss francs and Canadian dollars. The balance of the business covers a broad range of other currencies.

The counterparties to the Company's fixed income and foreign exchange transactions include investment advisors, commercial banks, insurance companies, investment banks, broker-dealers, investment funds and industrial companies.

Risk Management

The Company's risk management policies and related procedures are integrated with those of the Parent and its other consolidated subsidiaries. These policies and related procedures are administered on a coordinated global basis with consideration given to each subsidiary's, including the Company's, specific capital and regulatory requirements. For the discussion which follows, the term "Company" includes the Parent and its subsidiaries.

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 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 overall risk management policies for the Company and reviews the Company's performance relative to these policies. The Management Committee has created several Risk Committees to assist it in monitoring and reviewing the Company's risk management practices. 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 Risk, 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 Risk Departments have operational responsibility for measuring and monitoring aggregate market risk and credit risk, respectively, with respect to the Company's institutional securities 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 also reports to senior management, 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, volatilities, 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 trading division level and on an individual product basis. Aggregate market risk limits have been approved for the Company and for each major trading division. Additional market risk limits are assigned to trading desks and, as appropriate, products. 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

The Company's exposure to credit risk arises from the possibility that a customer or counterparty to a transaction might fail to perform under its contractual commitment, which could result in the Company incurring losses. The Company has credit guidelines that limit the Company's current and potential credit exposure to any one customer or counterparty and to aggregates of customers or counterparties by type of business activity. Specific credit risk limits based on these credit guidelines also are in place for each type of customer or counterparty (by rating category).

The Credit Department administers limits, monitors credit exposure, and periodically reviews the financial soundness of customers and counterparties. The Company manages the credit exposure relating to its trading activities in various ways, including entering into master netting agreements, collateral arrangements, and limiting the duration of exposure. Risk is mitigated in certain cases by closing out transactions, entering into risk reducing transactions, assigning transactions to other parties, or purchasing credit protection.

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, which, in the aggregate, represented approximately 5% of the Company's total assets at May 31, 2003. In addition, substantially all of the collateral held by the Company for reverse repurchase agreements or bonds borrowed, which together represented approximately 30% of the Company's total assets at May 31, 2003, 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 underwritings, 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

In the normal course of business, the Company enters into a variety of derivative contracts related to financial instruments. The Company uses forward and option contracts and futures in its trading activities. In addition, financial futures and forward contracts are actively traded by the Company and are used to hedge proprietary inventory. The Company also enters into delayed delivery, when-issued, warrant and option contracts involving securities. These instruments generally represent future commitments to exchange currencies or purchase or sell other financial instruments on specific terms at specified future dates. Certain of these products have maturities that do not extend beyond one year, while options and warrants on equities may have longer maturities.

The fair value (carrying amount) of derivative instruments represents the cost of replacing these instruments and is further described in Note 2. Future changes in interest rates, foreign currency exchange rates or the fair values of the financial instruments or indices underlying these contracts ultimately may result in cash settlements exceeding fair value amounts recognized in the consolidated statement of financial condition. The amounts in the following table represent unrealized gains on purchased exchange-traded and OTC options and other contracts (including foreign exchange and other forward contracts), net of any unrealized losses owed to the counterparties on offsetting positions in situations where netting is appropriate. These 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.

Credit risk with respect to derivative instruments arises from the failure of a counterparty to perform according to the terms of the contract. The Company's exposure to credit risk at any point in time is represented by the fair value of the contracts reported as assets. The Company monitors the creditworthiness of counterparties to these transactions on an ongoing basis and requests additional collateral when deemed necessary. The Company believes the ultimate settlement of the transactions outstanding at May 31, 2003 will not have a material effect on the Company's consolidated statement of financial condition.

The credit quality of the Company's trading-related derivatives (both listed and OTC) at May 31, 2003 is summarized in the table below, showing the fair value of the related assets by counterparty credit rating. The actual credit ratings are determined by external rating agencies or by equivalent ratings used by the Parent's Credit Risk Department:

(In millions of dollars)	AAA	AA	A[1]	BBB	Other Non Investment Grade	Totals
Fixed income securities contracts (including forward contracts and options)	$ 3	$ -	$ 3	$ -	$ -	$ 6
Foreign exchange forward contracts	120	1,004	833	144	229	2,330
Equity securities contracts (including warrants and options)	1,630	-	156	-	64	1,850
Total	$1,753	$1,004	$992	$144	$293	$4,186
Percent of total	42%	24%	24%	3%	7%	100%

[1] *Includes approximately $682 of derivative transactions with affiliates. The Company also has obtained assets posted as collateral by affiliated investment grade counterparties amounting to $156.*

NOTE 8 - Employee Compensation Plans

Employees of the Company participate in compensation plans sponsored by the Parent. The following summarizes these plans:

Equity-Based Compensation Plans
Certain employees of the Company participate in several of the Parent's equity-based stock compensation plans. The Parent applies the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for stock options and no expense has been recognized with respect to the granting of these stock options to the participating employees of the Company. In August 2002, the Parent announced that beginning in fiscal 2003 it will expense employee stock options in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation." Under SFAS No. 123, compensation expense will be recognized based on the fair value of stock options on the date of grant. The Company is in the process of evaluating the impact of adopting the fair value based method of accounting for stock-based employee compensation plans under SFAS No. 123.

In addition, certain employees of the Company participate in the Parent's Equity Incentive Compensation Plan whereby stock units representing employees' rights to receive unrestricted common shares of the Parent are awarded annually.

Profit Sharing Plan
The Parent sponsors a qualified non-contributory profit sharing plan covering substantially all U.S. employees. Contributions are made to eligible employees at the discretion of management based upon the financial performance of the Parent.

Employee Stock Ownership Plan
The Company participates in the Parent and Subsidiaries Employee Stock Ownership Plan ("ESOP") covering substantially all employees. Contributions to the ESOP by the Company and allocation of ESOP shares to employees are made annually at the discretion of the Parent's Board of Directors.

NOTE 9 -
Employee Benefit Plans

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

Pension Plans
Substantially all of the employees of the Company and its U.S. affiliates are covered by a non-contributory pension plan that is qualified under Section 401(a) of the Internal Revenue Code (the "Qualified Plan"). Unfunded supplemental plans (the "Supplemental Plans") cover certain executives. 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 Plan, 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 Supplementary Plans are accrued by the Company and are funded when paid to the beneficiaries.

The weighted-average discount rate, the rate of increase in future compensation levels and the expected long-term rate of return on plan assets used in determining the benefit obligation were 6.75%, 5% and 8.5%, respectively.

The following table provides a reconciliation of the changes in the benefit obligation and fair value of plan assets for fiscal 2002 as well as a summary of the funded status of the plans as of November 30, 2002:

	Qualified Plan	Supplemental Plans
Reconciliation of benefit obligation:		
Benefit obligation at beginning of year	$294,417	$200,807
Service cost	23,409	1,735
Interest cost	22,004	13,032
Actuarial loss (gain)	61,434	(25,056)
Benefits paid	(5,855)	(3,774)
Curtailments	-	(31,544)
Special termination benefits	2,790	320
Benefit obligation at end of year	398,199	155,520
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of year	245,153	-
Actual return on plan assets	(22,439)	-
Employer contributions	133,000	3,774
Benefits paid	(5,854)	(3,774)
Fair value of plan assets at end of year	349,860	0
Funded status:		
Unfunded status	(48,339)	(155,520)
Unrecognized transition obligation	-	333
Unrecognized prior-service cost	(290)	2,588
Unrecognized loss	136,550	20,952
Amount contributed to plan after measurement date	-	683
Net amount recognized	$87,921	$(130,964)

Postretirement Benefits

The Company has unfunded postretirement benefit plans that provide medical and life insurance for eligible retirees and dependents. At November 30, 2002, the Company's accrued postretirement benefit cost was $60,128.

NOTE 10 - Income Taxes

The Company is included in the consolidated federal income tax return filed by the Parent. Federal income taxes have been provided on a separate entity basis. The Company is included in the combined state and local income tax returns with the Parent and certain other subsidiaries of the Parent. State and local income taxes have been provided on separate entity income at the effective tax rate of the Company's combined filing group.

In accordance with the terms of the Tax Allocation Agreement with the Parent, all current and deferred taxes are offset with all other intercompany balances with the Parent.

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are primarily attributable to employee benefit plan payables.

Note 11 - Regulatory Requirements

MS&Co. is a registered broker-dealer and futures commission merchant and, accordingly, is subject to the Net Capital rules of the SEC, the CFTC and the New York Stock Exchange ("NYSE"). Under these rules, MS&Co. is required to maintain minimum Net Capital of not less than the greater of 2% of aggregate debit items arising from customer transactions, as defined, plus excess margin collateral on securities purchased under agreements to resell or 4% of funds required to be segregated for customers' regulated commodity accounts, as defined. The NYSE may require a member firm to reduce its business if net capital is less than 4% of such aggregate debit items and may prohibit a firm from expanding its business if net capital is less than 5% of such aggregate debit items. At May 31, 2003, MS&Co.'s Net Capital was $4,000,215, which exceeded the minimum requirement by $3,362,520 and included excess Net Capital of $750,725 of MS Securities Services Inc., a broker-dealer and a guaranteed subsidiary of MS&Co.

Advances to the Parent and its affiliates, repayment of subordinated liabilities, dividend payments and other equity withdrawals are subject to certain notification and other provisions of the Net Capital rules of the SEC.

During the six month period ended May 31, 2003, MS&Co. performed the computations for the assets in the proprietary accounts of its introducing brokers (commonly referred to as "PAIB") in accordance with the customer reserve computation set forth under SEC Rule 15c3-3 (the Customer Reserve Formula).

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