

CtW Investment Group

March 24, 2008

Dear fellow Morgan Stanley shareholder:

Morgan Stanley's first quarter results, released last week, underscore the need for a Board willing and able to check a willful CEO with a penchant for taking risk. **We therefore write to reiterate our recommendation that shareholders vote "Against" Directors Howard Davies, Robert Kidder and Chairman John Mack on April 8.** As Mark T. Williams, a former Federal Reserve Board bank examiner, concluded in last Thursday's *American Banker*:

Examples of firms with strong risk-control cultures include Goldman Sachs, JPMorgan Chase, Deutsche Bank, and Credit Suisse.... Those that have recently had devastating financial losses include Merrill Lynch, Citigroup, Morgan Stanley, UBS, and Bear Stearns.... One thing [the latter] all had in common was weak or lax risk controls and oversight. Until these companies fix their fundamental risk-control problems, including the lack of strong board and risk-management oversight, many of them will remain vulnerable to losses.

Removing Messrs. Davies and Kidder, and immediately naming an independent board chair, will enhance the Board's risk oversight and independence without destabilizing the company at an especially challenging moment.

Morgan Stanley's Q1 results underscore the need for an independent chairman and genuinely independent directors to balance CEO John Mack's appetite for risk with the firm's capacity to manage that risk.

As indicated in our March 12 letter to you, we believe Morgan Stanley's \$9.4 billion in subprime-related writedowns resulted from a business plan that aggressively expanded the firm's risk profile beyond its capacity to manage that risk. Mr. Mack assured investors last December that the firm had dialed down its risk appetite following such losses, saying that "I think that we have been sprinting and I think we're going to be kind of jogging right now for a while." Notwithstanding such assurances, Morgan Stanley took more risk in first quarter 2008 – as measured by average daily value at risk (VaR) – than any other quarter in its history.

Mr. Mack's 2005 CRO reporting change violated the fundamental principle of independence at the heart of sound risk management, with costly consequences for shareholders.

Formerly a direct report to the CEO, the firm's Chief Risk Officer began reporting to Co-President Zoe Cruz in October 2005. Because Ms. Cruz received a substantial annual cash bonus, presumably based on the performance of the Institutional Securities business – of which trading was the largest, riskiest and fastest growing revenue source – she had a financial incentive to take excessive short-term trading risk. Indeed, after Mr. Mack recently decided to have the CRO report to the CFO instead, he acknowledged the conflict of interest inherent in the

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earlier structure, saying “I think the right reporting line is not to the business unit head or the division head, but someone totally independent who reports directly to me and that's why we made the change.”

The fact that John Mack also named the CRO to the Management Committee in October 2005, as the independent directors note in their March 20 letter to you, is irrelevant: if the CRO believed the Co-President was allowing too much risk, he would have to go over her head, either to the Management Committee on which she also sat or to the CEO or Board. Even the most diligent employee would be understandably reluctant to do so.

Indeed, according to the *Financial Times* (12/22/07), this is essentially what happened:

Mr Daula, who was appointed to his [CRO] role in 2005, briefed Ms Cruz weekly on the bank's risk position, according to people familiar with the matter, although one said Mr Daula never took his concerns directly to Mr Mack. ...By August, Mr Daula was very vocal in saying that there were no proper pricing models for such trades, that positions were not being properly measured, and that the history traders used in their models was not a reliable guide, these people say.

The results are well known: Morgan Stanley failed to reduce its exposure to CDOs prior to fall 2007, when there was still liquidity in the market, and was subsequently forced to write down \$7.8 billion in CDO exposure from a single trading desk.

Conclusion: Vote “Against” Directors Davies, Kidder and Mack

The Board has taken steps to strengthen the firm’s risk management, but has yet to address the underlying failures that enabled Mr. Mack’s overly aggressive posture. While the entire Board and Audit Committee failed to keep management’s risk appetite in check, directors Kidder and Davies – as members of the Audit Committee in October 2005 – bear particular responsibility for allowing Mr. Mack to compromise the independence of the firm’s risk management by changing the CRO reporting line.

With first quarter earnings down 42% from the prior year, risk taking at record levels and the financial markets still uncertain, Morgan Stanley shareholders urgently need a strong, independent board to oversee management’s appetite for risk and ensure adequate risk controls. We urge you to vote “against” Directors Davies, Kidder and Mack.

We welcome the opportunity to review our concerns in greater detail with fellow shareholders. Please contact Michael Garland at 212-471-1317 to discuss these issues further and visit www.ctwinvestmentgroup.com for more information.

Sincerely,



William Patterson
Executive Director

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