

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

*This section of the Annual Report provides management's discussion and analysis ("MD&A") of the financial condition and results of operations of JPMorgan Chase. See the Glossary of terms on pages 181–183 of definitions of terms used throughout this Annual Report. The MD&A included in this Annual Report contains statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are based upon the current beliefs and expectations of JPMorgan Chase's management*

*and are subject to significant risks and uncertainties. These risks and uncertainties could cause JPMorgan Chase's results to differ materially from those set forth in such forward-looking statements. Certain of such risks and uncertainties are described herein (see Forward-looking statements on page 101 of this Annual Report) and in the JPMorgan Chase Annual Report on Form 10-K for the year ended December 31, 2007 ("2007 Form 10-K"), in Part I, Item 1A: Risk factors, to which reference is hereby made.*

## INTRODUCTION

JPMorgan Chase & Co., a financial holding company incorporated under Delaware law in 1968, is a leading global financial services firm and one of the largest banking institutions in the United States of America ("U.S."), with \$1.6 trillion in assets, \$123.2 billion in stockholders' equity and operations worldwide. The Firm is a leader in investment banking, financial services for consumers and businesses, financial transaction processing and asset management. Under the JPMorgan and Chase brands, the Firm serves millions of customers in the U.S. and many of the world's most prominent corporate, institutional and government clients.

JPMorgan Chase's principal bank subsidiaries are JPMorgan Chase Bank, National Association ("JPMorgan Chase Bank, N.A."), a national banking association with branches in 17 states; and Chase Bank USA, National Association ("Chase Bank USA, N.A."), a national bank that is the Firm's credit card issuing bank. JPMorgan Chase's principal nonbank subsidiary is J.P. Morgan Securities Inc., the Firm's U.S. primary investment banking firm.

JPMorgan Chase's activities are organized, for management reporting purposes, into six business segments, as well as Corporate. The Firm's wholesale businesses comprise the Investment Bank, Commercial Banking, Treasury & Securities Services and Asset Management segments. The Firm's consumer businesses comprise the Retail Financial Services and Card Services segments. A description of the Firm's business segments, and the products and services they provide to their respective client bases, follows.

### Investment Bank

JPMorgan is one of the world's leading investment banks, with deep client relationships and broad product capabilities. The Investment Bank's clients are corporations, financial institutions, governments and institutional investors. The Firm offers a full range of investment banking products and services in all major capital markets, including advising on corporate strategy and structure, capital raising in equity and debt markets, sophisticated risk management, market-making in cash securities and derivative instruments and research. The Investment Bank ("IB") also commits the Firm's own capital to proprietary investing and trading activities.

### Retail Financial Services

Retail Financial Services ("RFS"), which includes the Regional Banking, Mortgage Banking and Auto Finance reporting segments, serves consumers and businesses through bank branches, ATMs, online banking and telephone banking. Customers can use more than 3,100 bank branches (fourth-largest nationally), 9,100 ATMs (third-largest nationally) and 290 mortgage offices. More than 13,700 branch salespeople assist customers with checking and savings accounts, mortgages, home equity and business loans and investments across the 17-state footprint from New York to Arizona. Consumers also can obtain loans through more than 14,500 auto dealerships and 5,200 schools and universities nationwide.

### Card Services

With 155 million cards in circulation and more than \$157 billion in managed loans, Card Services ("CS") is one of the nation's largest credit card issuers. Customers used Chase cards to meet more than \$354 billion worth of their spending needs in 2007.

With hundreds of partnerships, Chase has a market leadership position in building loyalty programs with many of the world's most respected brands. The Chase-branded product line was strengthened in 2007 with enhancements to the popular Chase Freedom Program, which has generated more than one million new customers since its launch in 2006.

Chase Paymentech Solutions, LLC, a joint venture between JPMorgan Chase and First Data Corporation, is a processor of MasterCard and Visa payments, which handled more than 19 billion transactions in 2007.

### Commercial Banking

Commercial Banking ("CB") serves more than 30,000 clients nationally, including corporations, municipalities, financial institutions and not-for-profit entities with annual revenue generally ranging from \$10 million to \$2 billion. Commercial Banking delivers extensive industry knowledge, local expertise and a dedicated service model. In partnership with the Firm's other businesses, it provides comprehensive solutions including lending, treasury services, investment banking and asset management to meet its clients' domestic and international financial needs.

### Treasury & Securities Services

Treasury & Securities Services ("TSS") is a global leader in transaction, investment and information services. TSS is one of the world's largest cash management providers and a leading global custodian. Treasury Services ("TS") provides cash management, trade, wholesale card and liquidity products and services to small and mid-sized companies, multinational corporations, financial institutions and government entities. TS partners with the Commercial Banking, Retail Financial Services and Asset Management businesses to serve clients firmwide. As a result, certain TS revenue is included in other segments' results. Worldwide Securities Services ("WSS") holds, values, clears and services securities, cash and alternative investments for investors and broker-dealers, and manages depositary receipt programs globally.

### Asset Management

With assets under supervision of \$1.6 trillion, Asset Management ("AM") is a global leader in investment and wealth management. AM clients include institutions, retail investors and high-net-worth individuals in every major market throughout the world. AM offers global investment management in equities, fixed income, real estate, hedge funds, private equity and liquidity, including both money market instruments and bank deposits. AM also provides trust and estate and banking services to high-net-worth clients, and retirement services for corporations and individuals. The majority of AM's client assets are in actively managed portfolios.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### EXECUTIVE OVERVIEW

*This overview of management's discussion and analysis highlights selected information and may not contain all of the information that is important to readers of this Annual Report. For a more complete understanding of events, trends and uncertainties, as well as the capital, liquidity, credit and market risks, and the Critical accounting estimates, affecting the Firm and its various lines of business, this Annual Report should be read in its entirety.*

### Financial performance of JPMorgan Chase

Year ended December 31,

(in millions, except per share and ratio data)

	2007	2006	Change
<b>Selected income statement data</b>			
Total net revenue	\$ 71,372	\$ 61,999	15%
Provision for credit losses	6,864	3,270	110
Total noninterest expense	41,703	38,843	7
Income from continuing operations	15,365	13,649	13
Income from discontinued operations	—	795	NM
<b>Net income</b>	<b>15,365</b>	<b>14,444</b>	<b>6</b>
<b>Diluted earnings per share</b>			
Income from continuing operations	\$ 4.38	\$ 3.82	15%
Net income	4.38	4.04	8
<b>Return on common equity</b>			
Income from continuing operations	13%	12%	
Net income	13	13	

### Business overview

JPMorgan Chase reported record Net income and record Total net revenue in 2007, exceeding the record levels achieved in 2006. Net income in 2007 was \$15.4 billion, or \$4.38 per share, and Total net revenue was \$71.4 billion, compared with Net income of \$14.4 billion, or \$4.04 per share, and Total net revenue of \$62.0 billion for 2006. The return on common equity was 13% in both years. Reported results in 2006 included \$795 million of income from discontinued operations related to the exchange of selected corporate trust businesses for the consumer, business banking and middle-market banking businesses of The Bank of New York. Income from continuing operations in 2006 was \$13.6 billion, or \$3.82 per share. For a detailed discussion of the Firm's consolidated results of operations, see pages 31–35 of this Annual Report.

The Firm's results over the past several years have benefited from growth in the global economy and, most importantly, from the management team's focus on driving organic revenue growth and improving operating margins by investing in each line of business, reducing waste, efficiently using the Firm's balance sheet and successfully completing the integration plan for the merger of Bank One Corporation with and into JPMorgan Chase on July 1, 2004 ("the Merger"). The success in executing on this agenda in 2007 is reflected in the strong organic growth experienced by all of our businesses including: record levels of advisory fees, equity underwriting fees and equity markets revenue; double-digit revenue growth in Retail Financial Services, Treasury & Securities Services and Asset Management; and improved operating margins in most businesses. This improved performance was driven by growth in key business metrics including: double-digit growth in deposit and loan balances; 127 new branches and 680 additional ATMs; 15% growth in assets under custody; \$115 billion of net assets under management inflows; 16 million new credit card accounts with 1.4 million sold in branches; and nearly doubling real estate mortgage origination market share to 11% during the fourth quarter of 2007. At the same time the Firm increased loan loss reserve levels, and maintained strong capital ratios and ample levels of liquidity as part of its commitment to maintaining a strong balance sheet.

During 2007, the Firm also continued to create a stronger infrastructure. The Firm successfully completed the in-sourcing of its credit card processing platform, which will allow for faster introduction of new and enhanced products and services. In addition, with the successful completion of the systems conversion and rebranding for 339 former Bank of New York branches and the conversion of the wholesale deposit system (the last significant Merger event which affected more than \$180 billion in customer balances), the Firm's consumer and wholesale customers throughout the U.S. now have access to over 3,100 branches and 9,100 ATMs in 17 states, all of which are on common computer systems. With Merger integration activity completed by the end of 2007, the Firm fully realized its established merger-related expense savings target of \$3.0 billion. To achieve these merger-related savings, the Firm expensed Merger costs of \$209 million during 2007, bringing the total cumulative amount expensed since the Merger announcement to approximately \$3.6 billion (including costs associated with the Bank of New York transaction and capitalized costs). With the completion of all Merger integration activity, no further Merger costs will be incurred.

In 2007, the global economy continued to expand and inflation remained well-contained despite ongoing price pressures on energy and agricultural commodities. Developing economies maintained strong momentum throughout the year, but the industrial economies slowed in the second half of the year in response to weak housing conditions, monetary tightening by several central banks, rising petroleum prices and tightening credit conditions. The U.S. housing market for the first time in decades experienced a decline in average home prices with some specific markets declining by double-digit percentages. Despite the slowdown in the industrial economies, labor markets remained relatively healthy, supporting ongoing solid, though slowing consumer spending. Substantial financial losses related to U.S. subprime mortgage loans triggered a flight to quality in global financial markets late in the summer. In addition, during the second half of the year, pressures in interbank funding markets increased, credit spreads widened significantly and credit was difficult to obtain for some less creditworthy wholesale and consumer borrowers. Central banks took a number of actions to counter pressures in funding markets, including reducing interest rates and suspending further tightening actions. Capital markets activity increased significantly in the first half of 2007, but declined over the second half of the year amid difficult mortgage and credit market conditions. Despite the volatility in capital markets activity, U.S. and international equity markets performance was strong, with the U.S. stock market reaching an all-time record in October; however, the stock market pulled back from the record level by the end of the year. The S&P 500 and international indices were up, on average, approximately 8% during 2007.

The Firm's improved performance in 2007 benefited both from the investments made in each business and the overall global economic environment. The continued overall expansion of the U.S. and global economies, overall increased level of capital markets activity and positive performance in equity markets helped to drive new business volume and organic growth within each of the Firm's businesses. These

benefits were tempered by the capital markets environment in the second half of the year and the continued weakness in the U.S. housing market. The Investment Bank's lower results were significantly affected by the uncertain and extremely volatile capital markets environment, which resulted in significant markdowns on leveraged lending, subprime positions and securitized products. Retail Financial Services reported lower earnings, reflecting an increase in the Provision for credit losses and higher net charge-offs for the home equity and subprime mortgage loan portfolios related to the weak housing market. Card Services earnings also decreased driven by an increased Provision for credit losses, reflecting a higher level of net charge-offs. The other lines of business each posted improved results versus 2006. Asset Management, Treasury & Securities Services and Commercial Banking reported record revenue and earnings in 2007, and Private Equity posted very strong results.

*The discussion that follows highlights the performance of each business segment compared with the prior year, and discusses results on a managed basis unless otherwise noted. For more information about managed basis, see Explanation and reconciliation of the Firm's use of non-GAAP financial measures on pages 36–37 of this Annual Report.*

**Investment Bank** net income decreased from the prior year, driven by lower Total net revenue and a higher Provision for credit losses. The decline in Total net revenue was driven by lower Fixed Income Markets revenue due to markdowns on subprime positions, including subprime collateralized debt obligations ("CDOs"); markdowns on leverage lending funded loans and unfunded commitments; markdowns in securitized products on nonsubprime mortgages and weak credit trading performance. Partially offsetting the decline in revenue were strong investment banking fees, driven by record advisory and record equity underwriting fees; record Equity Markets revenue, which benefited from strong client activity and record trading results; and record revenue in currencies and strong revenue in rates. The Provision for credit losses rose due to an increase in the Allowance for credit losses, primarily resulting from portfolio activity, which included the effect of the weakening credit environment, and portfolio growth.

**Retail Financial Services** net income declined compared with the prior year. Growth in Total net revenue was more than offset by a significant increase in the Provision for credit losses and higher Total noninterest expense. The increase in Total net revenue was due to higher net mortgage servicing revenue; higher deposit-related fees; the absence of prior-year losses related to mortgage loans transferred to held-for-sale; wider spreads on loans; and higher deposit balances. Revenue also benefited from the Bank of New York transaction and the classification of certain mortgage loan origination costs as expense due to the adoption of SFAS 159. The increase in the Provision for credit losses was due primarily to an increase in the Allowance for loan losses related to home equity loans and subprime mortgage loans, as weak housing prices throughout the year resulted in an increase in estimated losses for both categories of loans. Total noninterest expense increased due to the Bank of New York transaction, the classification of certain loan origination costs as expense due to the adoption of SFAS 159 ("Fair Value Option"), investments in the retail distribution network and higher mortgage production and servicing expense. These increases were offset partially by the sale of the insurance business.

**Card Services** net income declined compared with the prior year due to an increase in the Provision for credit losses, partially offset by Total net managed revenue growth and a reduction in Total noninterest expense. The growth in Total net managed revenue reflected a higher level of fees, growth in average loan balances and increased net interchange income. These benefits were offset partially by narrower loan spreads, the discontinuation of certain billing practices (including the elimination of certain over-limit fees and the two-cycle billing method for calculating finance charges) and the effect of higher revenue reversals associated with higher charge-offs. The Managed provision for credit losses increased primarily due to a higher level of net charge-offs (the prior year benefited from the change in bankruptcy legislation in the fourth quarter of 2005) and an increase in the allowance for loan losses driven by higher estimated net charge-offs in the portfolio. Total noninterest expense declined from 2006, primarily due to lower marketing expense and lower fraud-related expense, partially offset by higher volume-related expense.

**Commercial Banking** posted record net income as record Total net revenue was offset partially by a higher Provision for credit losses. Total net revenue reflected growth in liability balances and loans, increased deposit-related fees and higher investment banking revenue. These benefits were offset partially by a continued shift to narrower-spread liability products and spread compression in the loan and liability portfolios. The Provision for credit losses increased from the prior year, reflecting portfolio activity, including slightly lower credit quality, as well as growth in loan balances. Total noninterest expense decreased slightly, as lower compensation expense was offset by higher volume-related expense related to the Bank of New York transaction.

**Treasury & Securities Services** generated record net income driven by record Total net revenue, partially offset by higher Total noninterest expense. Total net revenue benefited from increased product usage by new and existing clients, market appreciation, wider spreads in securities lending, growth in electronic volumes and higher liability balances. These benefits were offset partially by spread compression and a shift to narrower-spread liability products. Total noninterest expense increased due primarily to higher expense related to business and volume growth, as well as investment in new product platforms.

**Asset Management** produced record net income, which benefited from record Total net revenue, partially offset by higher Total noninterest expense. Total net revenue grew as a result of increased assets under management, higher performance and placement fees, and higher deposit and loan balances. Total noninterest expense was up, largely due to higher performance-based compensation expense and investments in all business segments.

**Corporate** net income increased from the prior year due primarily to increased Total net revenue. Total net revenue growth was driven by significantly higher Private Equity gains compared with the prior year, reflecting a higher level of gains and the change in classification of carried interest to compensation expense. Revenue also benefited from a higher level of security gains and an improved net interest spread. Total noninterest expense increased due primarily to higher net litigation expense driven by credit card-related litigation and higher compensation expense.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

Income from discontinued operations was \$795 million in 2006, which included a one-time gain of \$622 million from the sale of selected corporate trust businesses. Discontinued operations (included in the Corporate segment results) included the income statement activity of selected corporate trust businesses sold to The Bank of New York in October 2006.

The Firm's Managed provision for credit losses was \$9.2 billion compared with \$5.5 billion in the prior year, reflecting increases in both the wholesale and consumer provisions. The total consumer Managed provision for credit losses was \$8.3 billion, compared with \$5.2 billion in the prior year. The higher provision primarily reflected increases in the Allowance for credit losses largely related to home equity, credit card and subprime mortgage loans and higher net charge-offs. Consumer managed net charge-offs were \$6.8 billion in 2007, compared with \$5.3 billion in 2006, resulting in managed net charge-off rates of 1.97% and 1.60%, respectively. The wholesale Provision for credit losses was \$934 million, compared with \$321 million in the prior year. The increase was due primarily to a higher Allowance for credit losses, resulting primarily from portfolio activity, including the effect of the weakening credit environment, and portfolio growth.

Wholesale net charge-offs were \$72 million in 2007 (net charge-off rate of 0.04%), compared with net recoveries of \$22 million in 2006 (net recovery rate of 0.01%). In total, the Firm increased its Allowance for credit losses in 2007 by \$2.3 billion, bringing the balance of the allowance to \$10.1 billion at December 31, 2007.

The Firm had, at year end, Total stockholders' equity of \$123.2 billion and a Tier 1 capital ratio of 8.4%. The Firm purchased \$8.2 billion, or 168 million shares, of its common stock during the year.

### 2008 Business outlook

*The following forward-looking statements are based upon the current beliefs and expectations of JPMorgan Chase's management and are subject to significant risks and uncertainties. These risks and uncertainties could cause JPMorgan Chase's results to differ materially from those set forth in such forward-looking statements.*

JPMorgan Chase's outlook for 2008 should be viewed against the backdrop of the global and U.S. economies (which currently are extremely volatile), financial markets activity (including interest rate movements), the geopolitical environment, the competitive environment and client activity levels. Each of these linked factors will affect the performance of the Firm's lines of business. The Firm currently anticipates a lower level of growth globally and in the U.S. during 2008 and increased credit costs in all businesses. The slower the growth is, or the weaker the economic conditions are, compared with current forecasts, the more the Firm's financial results could be adversely affected.

The consumer Provision for credit losses could increase substantially as a result of a higher level of losses in Retail Financial Services' \$94.8 billion home equity loan portfolio and growth and increased losses in the \$15.5 billion retained subprime mortgage loan portfolio. Given the potential stress on the consumer from continued downward pressure on housing prices and the elevated inventory of unsold houses nationally, management remains extremely cautious with respect to the home equity and subprime mortgage portfolios. Economic data

released in early 2008, including continued declines in housing prices and increasing unemployment, indicate that losses will likely continue to rise in the home equity portfolio. In addition, the consumer provision could increase due to a higher level of net charge-offs in Card Services. Based on management's current economic outlook, home equity losses for the first quarter of 2008 could be approximately \$450 million and net charge-offs could potentially double from this level by the fourth quarter of 2008, and the net charge-off rate for Card Services could potentially increase to approximately 4.50% of managed loans in the first half of 2008 and to approximately 5.00% by the end of 2008. Net charge-offs for home equity and card services could be higher than management's current expectations depending on such factors as changes in housing prices, unemployment levels and consumer behavior. The wholesale Provision for credit losses may also increase over time as a result of loan growth, portfolio activity and changes in underlying credit conditions.

The Investment Bank enters 2008 with the capital markets still being affected by the disruption in the credit and mortgage markets, as well as by overall lower levels of liquidity and wider credit spreads, all of which could potentially lead to reduced levels of client activity, difficulty in syndicating leveraged loans, lower investment banking fees and lower trading revenue. While some leveraged finance loans were sold during the fourth quarter of 2007, the Firm held \$26.4 billion of leveraged loans and unfunded commitments as held-for-sale as of December 31, 2007. Markdowns in excess of 6% have been taken on the leveraged lending positions as of year-end 2007. These positions are difficult to hedge effectively and as market conditions have continued to deteriorate in the first quarter of 2008, it is likely there will be further markdowns on this asset class. In January 2008, the Firm decided, based on its view of potential relative returns, to retain for investment \$4.9 billion of the leveraged lending portfolio that had been previously held-for-sale. The Investment Bank also held, at year end, an aggregate \$2.7 billion of subprime CDOs and other subprime-related exposures which could also be negatively affected by market conditions during 2008. While these positions are substantially hedged (none of the hedges include insurance from monoline insurance companies), there can be no assurance that the Firm will not incur additional losses on these positions, as these markets are illiquid and further writedowns may be necessary. Other exposures as of December 31, 2007 that have higher levels of risk given the current market environment include CDO warehouse and trading positions of \$5.5 billion (over 90% corporate loans and bonds); Commercial Mortgage-Backed Securities ("CMBS") exposure of \$15.5 billion; and \$6.4 billion of Alt-A mortgage positions.

A weaker economy and lower equity markets in 2008 would also adversely affect business volumes, assets under custody and assets under management in Asset Management and Treasury & Securities Services. Management continues to believe that the net loss in Treasury and Other Corporate on a combined basis will be approximately \$50 million to \$100 million per quarter over time. Private equity results, which are dependent upon the capital markets, could continue to be volatile and may be significantly lower in 2008 than in 2007. For the first quarter of 2008, private equity gains are expected to be minimal.

## CONSOLIDATED RESULTS OF OPERATIONS

*The following section provides a comparative discussion of JPMorgan Chase's Consolidated results of operations on a reported basis for the three-year period ended December 31, 2007. Factors that relate primarily to a single business segment are discussed in more detail within that business segment than they are in this consolidated section. For a discussion of the Critical accounting estimates used by the Firm that affect the Consolidated results of operations, see pages 96–98 of this Annual Report.*

### Revenue

Year ended December 31, (in millions)	2007	2006	2005
Investment banking fees	\$ 6,635	\$ 5,520	\$ 4,088
Principal transactions	9,015	10,778	8,072
Lending & deposit-related fees	3,938	3,468	3,389
Asset management, administration and commissions	14,356	11,855	9,988
Securities gains (losses)	164	(543)	(1,336)
Mortgage fees and related income	2,118	591	1,054
Credit card income	6,911	6,913	6,754
Other income	1,829	2,175	2,684
<b>Noninterest revenue</b>	<b>44,966</b>	<b>40,757</b>	<b>34,693</b>
<b>Net interest income</b>	<b>26,406</b>	<b>21,242</b>	<b>19,555</b>
<b>Total net revenue</b>	<b>\$ 71,372</b>	<b>\$ 61,999</b>	<b>\$ 54,248</b>

### 2007 compared with 2006

Total net revenue of \$71.4 billion was up \$9.4 billion, or 15%, from the prior year. Higher Net interest income, very strong private equity gains, record Asset management, administration and commissions revenue, higher Mortgage fees and related income and record Investment banking fees contributed to the revenue growth. These increases were offset partially by lower trading revenue.

Investment banking fees grew in 2007 to a level higher than the previous record set in 2006. Record advisory and equity underwriting fees drove the results, partially offset by lower debt underwriting fees. For a further discussion of Investment banking fees, which are primarily recorded in IB, see the IB segment results on pages 40–42 of this Annual Report.

Principal transactions revenue consists of trading revenue and private equity gains. Trading revenue declined significantly from the 2006 level, primarily due to markdowns in IB of \$1.4 billion (net of hedges) on subprime positions, including subprime CDOs, and \$1.3 billion (net of fees) on leveraged lending funded loans and unfunded commitments. Also in IB, markdowns in securitized products on nonsubprime mortgages and weak credit trading performance more than offset record revenue in currencies and strong revenue in both rates and equities. Equities benefited from strong client activity and record trading results across all products. IB's Credit Portfolio results increased compared with the prior year, primarily driven by higher revenue from risk management activities. The increase in private equity

gains from 2006 reflected a significantly higher level of gains, the classification of certain private equity carried interest as Compensation expense and a fair value adjustment in the first quarter of 2007 on nonpublic private equity investments resulting from the adoption of SFAS 157 ("Fair Value Measurements"). For a further discussion of Principal transactions revenue, see the IB and Corporate segment results on pages 40–42 and 59–60, respectively, and Note 6 on page 122 of this Annual Report.

Lending & deposit-related fees rose from the 2006 level, driven primarily by higher deposit-related fees and the Bank of New York transaction. For a further discussion of Lending & deposit-related fees, which are mostly recorded in RFS, TSS and CB, see the RFS segment results on pages 43–48, the TSS segment results on pages 54–55, and the CB segment results on pages 52–53 of this Annual Report.

Asset management, administration and commissions revenue reached a level higher than the previous record set in 2006. Increased assets under management and higher performance and placement fees in AM drove the record results. The 18% growth in assets under management from year-end 2006 came from net asset inflows and market appreciation across all segments: Institutional, Retail, Private Bank and Private Client Services. TSS also contributed to the rise in Asset management, administration and commissions revenue, driven by increased product usage by new and existing clients and market appreciation on assets under custody. Finally, commissions revenue increased, due mainly to higher brokerage transaction volume (primarily included within Fixed Income and Equity Markets revenue of IB), which more than offset the sale of the insurance business by RFS in the third quarter of 2006 and a charge in the first quarter of 2007 resulting from accelerated surrenders of customer annuities. For additional information on these fees and commissions, see the segment discussions for IB on pages 40–42, RFS on pages 43–48, TSS on pages 54–55, and AM on pages 56–58, of this Annual Report.

The favorable variance resulting from Securities gains in 2007 compared with Securities losses in 2006 was primarily driven by improvements in the results of repositioning of the Treasury investment securities portfolio. Also contributing to the positive variance was a \$234 million gain from the sale of MasterCard shares. For a further discussion of Securities gains (losses), which are mostly recorded in the Firm's Treasury business, see the Corporate segment discussion on pages 59–60 of this Annual Report.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

Mortgage fees and related income increased from the prior year as mortgage servicing rights ("MSRs") asset valuation adjustments and growth in third-party mortgage loans serviced drove an increase in net mortgage servicing revenue. Production revenue also grew, as an increase in mortgage loan originations and the classification of certain loan origination costs as expense (loan origination costs previously netted against revenue commenced being recorded as an expense in the first quarter of 2007 due to the adoption of SFAS 159) more than offset markdowns on the mortgage warehouse and pipeline. For a discussion of Mortgage fees and related income, which is recorded primarily in RFS's Mortgage Banking business, see the Mortgage Banking discussion on pages 46–47 of this Annual Report.

Credit card income remained relatively unchanged from the 2006 level, as lower servicing fees earned in connection with securitization activities, which were affected unfavorably by higher net credit losses and narrower loan margins, were offset by increases in net interchange income earned on the Firm's credit and debit cards. For further discussion of Credit card income, see CS's segment results on pages 49–51 of this Annual Report.

Other income declined compared with the prior year, driven by lower gains from loan sales and workouts, and the absence of a \$103 million gain in the second quarter of 2006 related to the sale of MasterCard shares in its initial public offering. (The 2007 gain on the sale of MasterCard shares was recorded in Securities gains (losses) as the shares were transferred to the available-for-sale ("AFS") portfolio subsequent to the IPO.) Increased income from automobile operating leases and higher gains on the sale of leveraged leases and education loans partially offset the decline.

Net interest income rose from the prior year, primarily due to the following: higher trading-related Net interest income, due to a shift of Interest expense to Principal transactions revenue (related to certain IB structured notes to which fair value accounting was elected in connection with the adoption of SFAS 159); growth in liability and deposit balances in the wholesale and consumer businesses; a higher level of credit card loans; the impact of the Bank of New York transaction; and an improvement in Treasury's net interest spread. These benefits were offset partly by a shift to narrower-spread deposit and liability products. The Firm's total average interest-earning assets for 2007 were \$1.1 trillion, up 12% from the prior year. The increase was primarily driven by higher Trading assets – debt instruments, Loans, and AFS securities, partially offset by a decline in Interests in purchased receivables as a result of the restructuring and deconsolidation during the second quarter of 2006 of certain multi-seller conduits that the Firm administered. The net interest yield on these assets, on a fully taxable equivalent basis, was 2.39%, an increase of 23 basis points from the prior year, due in part to the adoption of SFAS 159.

### 2006 compared with 2005

Total net revenue for 2006 was \$62.0 billion, up \$7.8 billion, or 14%, from the prior year. The increase was due to higher Principal transactions revenue, primarily from strong trading results, higher Asset management, administration and commission revenue and growth in Investment banking fees. Also contributing to the increase was higher Net interest income and lower securities portfolio losses. These improvements were offset partially by a decline in Other income partly as a result of the gain recognized in 2005 on the sale of BrownCo, the on-line deep discount brokerage business, and lower Mortgage fees and related income.

The increase in Investment banking fees was driven by strong growth in debt and equity underwriting, as well as advisory fees. For further discussion of Investment banking fees, which are primarily recorded in IB, see the IB segment results on pages 40–42 of this Annual Report.

Revenue from Principal transactions activities increased compared with the prior year, partly driven by strong trading revenue results due to improved performance in IB Equity and Fixed income markets, partially offset by lower private equity gains. For a further discussion of Principal transactions revenue, see the IB and Corporate segment results on pages 40–42 and 59–60, respectively, and Note 6 on page 122 of this Annual Report.

Lending & deposit-related fees rose slightly in comparison with the prior year as a result of higher fee income on deposit-related fees and, in part, from the Bank of New York transaction. For a further discussion of Lending & deposit-related fees, which are mostly recorded in RFS, TSS and CB, see the RFS segment results on pages 43–48, the TSS segment results on pages 54–55, and the CB segment results on pages 52–53 of this Annual Report.

The increase in Asset management, administration and commissions revenue in 2006 was driven by growth in assets under management in AM, which exceeded \$1 trillion at the end of 2006, higher equity-related commissions in IB and higher performance and placement fees. The growth in assets under management reflected new asset inflows in the Institutional and Retail segments. TSS also contributed to the rise in Asset management, administration and commissions revenue, driven by increased product usage by new and existing clients and market appreciation on assets under custody. In addition, commissions in the IB rose as a result of strength across regions, partly offset by the sale of the insurance business and BrownCo. For additional information on these fees and commissions, see the segment discussions for IB on pages 40–42, RFS on pages 43–48, TSS on pages 54–55, and AM on pages 56–58, of this Annual Report.

The favorable variance in Securities gains (losses) was due primarily to lower Securities losses in Treasury in 2006 from portfolio repositioning

activities in connection with the management of the Firm's assets and liabilities. For a further discussion of Securities gains (losses), which are mostly recorded in the Firm's Treasury business, see the Corporate segment discussion on pages 59–60 of this Annual Report.

Mortgage fees and related income declined in comparison with the prior year, reflecting a reduction in net mortgage servicing revenue and higher losses on mortgage loans transferred to held-for-sale. These declines were offset partly by growth in production revenue as a result of a higher volume of loan sales and wider gain on sale margins. For a discussion of Mortgage fees and related income, which is recorded primarily in RFS's Mortgage Banking business, see the Mortgage Banking discussion on pages 46–47 of this Annual Report.

Credit card income increased from the prior year, primarily from higher customer charge volume that favorably affected interchange income and servicing fees earned in connection with securitization activities, which benefited from lower credit losses incurred on securitized credit card loans. These increases were offset partially by increases in volume-driven payments to partners, expense related to reward programs, and interest paid to investors in securitized loans. Credit card income also was affected negatively by the deconsolidation of Paymentech in the fourth quarter of 2005.

The decrease in Other income compared with the prior year was due to a \$1.3 billion pretax gain recognized in 2005 on the sale of BrownCo and lower gains from loan workouts. Partially offsetting these two items were higher automobile operating lease revenue; an increase in equity investment income, in particular, from Chase Paymentech Solutions, LLC; and a pretax gain of \$103 million on the sale of MasterCard shares in its initial public offering.

Net interest income rose compared with the prior year due largely to improvement in Treasury's net interest spread and increases in wholesale liability balances, wholesale and consumer loans, AFS securities and consumer deposits. Increases in consumer and wholesale loans and deposits included the impact of the Bank of New York transaction. These increases were offset partially by narrower spreads on both trading-related assets and loans, a shift to narrower-spread deposits products, RFS's sale of the insurance business and the absence of BrownCo in AM. The Firm's total average interest-earning assets in 2006 were \$995.5 billion, up 11% from the prior year, primarily as a result of an increase in loans and other liquid earning assets, partially offset by a decline in Interests in purchased receivables as a result of the restructuring and deconsolidation during the second quarter of 2006 of certain multi-seller conduits that the Firm administered. The net yield on interest-earning assets, on a fully taxable-equivalent basis, was 2.16%, a decrease of four basis points from the prior year.

## Provision for credit losses

Year ended December 31, (in millions)	2007	2006	2005
Provision for credit losses	<b>\$ 6,864</b>	\$ 3,270	\$ 3,483

### 2007 compared with 2006

The Provision for credit losses in 2007 rose \$3.6 billion from the prior year due to increases in both the consumer and wholesale provisions. The increase in the consumer provision from the prior year was largely due to an increase in estimated losses related to home equity, credit card and subprime mortgage loans. Credit card net charge-offs in 2006 benefited following the change in bankruptcy legislation in the fourth quarter of 2005. The increase in the wholesale provision from the prior year primarily reflected an increase in the Allowance for credit losses due to portfolio activity, which included the effect of the weakening credit environment and portfolio growth. For a more detailed discussion of the loan portfolio and the Allowance for loan losses, see the segment discussions for RFS on pages 43–48, CS on pages 49–51, IB on pages 40–42, CB on pages 52–53 and Credit risk management on pages 73–89 of this Annual Report.

### 2006 compared with 2005

The Provision for credit losses in 2006 declined \$213 million from the prior year due to a \$1.3 billion decrease in the consumer Provision for credit losses, partly offset by a \$1.1 billion increase in the wholesale Provision for credit losses. The decrease in the consumer provision was driven by CS, reflecting lower bankruptcy-related losses, partly offset by higher contractual net charge-offs. The 2005 consumer provision also reflected a \$350 million special provision related to Hurricane Katrina, a portion of which was released in 2006. The increase in the wholesale provision was due primarily to portfolio activity, partly offset by a decrease in nonperforming loans. The benefit in 2005 was due to strong credit quality, reflected in significant reductions in criticized exposure and nonperforming loans. Credit quality in the wholesale portfolio was stable.

## Noninterest expense

Year ended December 31, (in millions)	2007	2006	2005
Compensation expense	<b>\$ 22,689</b>	\$ 21,191	\$ 18,065
Occupancy expense	<b>2,608</b>	2,335	2,269
Technology, communications and equipment expense	<b>3,779</b>	3,653	3,602
Professional & outside services	<b>5,140</b>	4,450	4,662
Marketing	<b>2,070</b>	2,209	1,917
Other expense	<b>3,814</b>	3,272	6,199
Amortization of intangibles	<b>1,394</b>	1,428	1,490
Merger costs <sup>(a)</sup>	<b>209</b>	305	722
<b>Total noninterest expense</b>	<b>\$ 41,703</b>	\$ 38,843	\$ 38,926

(a) On July 1, 2004, Bank One Corporation merged with and into JPMorgan Chase.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### 2007 compared with 2006

Total noninterest expense for 2007 was \$41.7 billion, up \$2.9 billion, or 7%, from the prior year. The increase was driven by higher Compensation expense, as well as investments across the business segments and acquisitions.

The increase in Compensation expense from 2006 was primarily the result of investments and acquisitions in the businesses, including additional headcount from the Bank of New York transaction; the classification of certain private equity carried interest from Principal transactions revenue; the classification of certain loan origination costs (loan origination costs previously netted against revenue commenced being recorded as an expense in the first quarter of 2007 due to the adoption of SFAS 159); and higher performance-based incentives. Partially offsetting these increases were business divestitures and continuing business efficiencies.

The increase in Occupancy expense from 2006 was driven by ongoing investments in the businesses; in particular, the retail distribution network and the Bank of New York transaction.

Technology, communications and equipment expense increased compared with 2006, due primarily to higher depreciation expense on owned automobiles subject to operating leases in the Auto Finance business in RFS and technology investments to support business growth. Continuing business efficiencies partially offset these increases.

Professional & outside services rose from the prior year, primarily reflecting higher brokerage expense and credit card processing costs resulting from growth in transaction volume. Investments in the businesses and acquisitions also contributed to the increased expense.

Marketing expense declined compared with 2006 due largely to lower credit card marketing expense.

The increase in Other expense from the 2006 level was driven by increased net legal-related costs reflecting a lower level of insurance recoveries and higher expense, which included the cost of credit card-related litigation. Also contributing to the increase were business growth and investments in the businesses, offset partially by the sale of the insurance business at the beginning of the third quarter of 2006, lower credit card fraud-related losses and continuing business efficiencies.

For a discussion of Amortization of intangibles and Merger costs, refer to Note 18 and Note 11 on pages 154–157 and 134, respectively, of this Annual Report.

### 2006 compared with 2005

Total noninterest expense for 2006 was \$38.8 billion, down slightly from the prior year. The decrease was due to material litigation-related insurance recoveries of \$512 million in 2006 compared with a net charge of \$2.6 billion (includes \$208 million of material litigation-related insurance recoveries) in 2005, primarily associated with the settlement of the Enron Corp. and its subsidiaries ("Enron") and WorldCom class action litigations and for certain other material legal proceedings. Also con-

tributing to the decrease were lower Merger costs, the deconsolidation of Paymentech, the sale of the insurance business, and merger-related savings and operating efficiencies. These items were offset mostly by higher performance-based compensation and incremental expense of \$712 million related to the adoption of SFAS 123R, the impact of acquisitions and investments in the businesses, and higher marketing expenditures.

The increase in Compensation expense from the prior year was primarily a result of higher performance-based incentives, incremental expense related to SFAS 123R of \$712 million for 2006, and additional headcount in connection with growth in business volume, acquisitions, and investments in the businesses. These increases were offset partially by merger-related savings and other expense efficiencies throughout the Firm. For a detailed discussion of the adoption of SFAS 123R and employee stock-based incentives, see Note 10 on pages 131–133 of this Annual Report.

The increase in Occupancy expense from the prior year was due to ongoing investments in the retail distribution network, which included the incremental expense from The Bank of New York branches, partially offset by merger-related savings and other operating efficiencies.

The slight increase in Technology, communications and equipment expense for 2006 was due primarily to higher depreciation expense on owned automobiles subject to operating leases and higher technology investments to support business growth, partially offset by merger-related savings and continuing business efficiencies.

Professional & outside services decreased from the prior year due to merger-related savings and continuing business efficiencies, lower legal fees associated with several legal matters settled in 2005 and the Paymentech deconsolidation. The decrease was offset partly by acquisitions and investments in the businesses.

Marketing expense was higher compared with the prior year, reflecting the costs of credit card campaigns.

Other expense was lower due to significant litigation-related charges of \$2.8 billion in the prior year, associated with the settlement of the Enron and WorldCom class action litigations and certain other material legal proceedings. In addition, the Firm recognized insurance recoveries of \$512 million and \$208 million, in 2006 and 2005, respectively, pertaining to certain material litigation matters. For further discussion of litigation, refer to Note 29 on pages 167–168 of this Annual Report. Also contributing to the decline from the prior year were charges of \$93 million in connection with the termination of a client contract in TSS in 2005; and in RFS, the sale of the insurance business in the third quarter of 2006. These items were offset partially by higher charges related to other litigation, and the impact of growth in business volume, acquisitions and investments in the businesses.

For a discussion of Amortization of intangibles and Merger costs, refer to Note 18 and Note 11 on pages 154–157 and 134, respectively, of this Annual Report.

## Income tax expense

The Firm's Income from continuing operations before income tax expense, Income tax expense and effective tax rate were as follows for each of the periods indicated.

Year ended December 31, (in millions, except rate)	2007	2006	2005
<b>Income from continuing operations before income tax expense</b>	<b>\$22,805</b>	<b>\$19,886</b>	<b>\$11,839</b>
Income tax expense	7,440	6,237	3,585
Effective tax rate	32.6%	31.4%	30.3%

### 2007 compared with 2006

The increase in the effective tax rate for 2007, as compared with the prior year, was primarily the result of higher reported pretax income combined with changes in the proportion of income subject to federal, state and local taxes. Also contributing to the increase in the effective tax rate was the recognition in 2006 of \$367 million of benefits related to the resolution of tax audits.

For further discussion of income taxes, see Critical accounting estimates and Note 26 on pages 96–98 and 164–165, respectively, of this Annual Report.

### 2006 compared with 2005

The increase in the effective tax rate for 2006, as compared with the prior year, was primarily the result of higher reported pretax income combined with changes in the proportion of income subject to federal, state and local taxes. Also contributing to the increase in the effective tax rate were the litigation charges in 2005 and lower Merger costs, reflecting a tax benefit at a 38% marginal tax rate, partially offset by benefits related to tax audit resolutions of \$367 million in 2006.

## Income from discontinued operations

As a result of the transaction with The Bank of New York on October 1, 2006, the results of operations of the selected corporate trust businesses (i.e., trustee, paying agent, loan agency and document management services) were reported as discontinued operations.

The Firm's Income from discontinued operations was as follows for each of the periods indicated.

Year ended December 31, (in millions)	2007	2006	2005
Income from discontinued operations	\$ —	\$ 795	\$ 229

The increase in 2006 was due primarily to a gain of \$622 million from exiting selected corporate trust businesses in the fourth quarter of 2006.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### EXPLANATION AND RECONCILIATION OF THE FIRM'S USE OF NON-GAAP FINANCIAL MEASURES

The Firm prepares its Consolidated financial statements using accounting principles generally accepted in the United States of America ("U.S. GAAP"); these financial statements appear on pages 104–107 of this Annual Report. That presentation, which is referred to as "reported basis," provides the reader with an understanding of the Firm's results that can be tracked consistently from year to year and enables a comparison of the Firm's performance with other companies' U.S. GAAP financial statements.

In addition to analyzing the Firm's results on a reported basis, management reviews the Firm's and the lines' of business results on a "managed" basis, which is a non-GAAP financial measure. The Firm's definition of managed basis starts with the reported U.S. GAAP results and includes certain reclassifications that assume credit card loans securitized by CS remain on the balance sheet and presents

revenue on a fully taxable-equivalent ("FTE") basis. These adjustments do not have any impact on Net income as reported by the lines of business or by the Firm as a whole.

The presentation of CS results on a managed basis assumes that credit card loans that have been securitized and sold in accordance with SFAS 140 still remain on the Consolidated balance sheets and that the earnings on the securitized loans are classified in the same manner as the earnings on retained loans recorded on the Consolidated balance sheets. JPMorgan Chase uses the concept of managed basis to evaluate the credit performance and overall financial performance of the entire managed credit card portfolio. Operations are funded and decisions are made about allocating resources, such as employees and capital, based upon managed financial information. In addition, the same underwriting standards

The following summary table provides a reconciliation from the Firm's reported U.S. GAAP results to managed basis.

(Table continues on next page)

Year ended December 31, (in millions, except per share and ratio data)	2007				2006			
	Reported results	Credit card <sup>(b)</sup>	Fully tax-equivalent adjustments	Managed basis	Reported results	Credit card <sup>(b)</sup>	Fully tax-equivalent adjustments	Managed basis
<b>Revenue</b>								
Investment banking fees	\$ 6,635	\$ —	\$ —	\$ 6,635	\$ 5,520	\$ —	\$ —	\$ 5,520
Principal transactions	9,015	—	—	9,015	10,778	—	—	10,778
Lending & deposit-related fees	3,938	—	—	3,938	3,468	—	—	3,468
Asset management, administration and commissions	14,356	—	—	14,356	11,855	—	—	11,855
Securities gains (losses)	164	—	—	164	(543)	—	—	(543)
Mortgage fees and related income	2,118	—	—	2,118	591	—	—	591
Credit card income	6,911	(3,255)	—	3,656	6,913	(3,509)	—	3,404
Other income	1,829	—	683	2,512	2,175	—	676	2,851
<b>Noninterest revenue</b>	<b>44,966</b>	<b>(3,255)</b>	<b>683</b>	<b>42,394</b>	<b>40,757</b>	<b>(3,509)</b>	<b>676</b>	<b>37,924</b>
<b>Net interest income</b>	<b>26,406</b>	<b>5,635</b>	<b>377</b>	<b>32,418</b>	<b>21,242</b>	<b>5,719</b>	<b>228</b>	<b>27,189</b>
<b>Total net revenue</b>	<b>71,372</b>	<b>2,380</b>	<b>1,060</b>	<b>74,812</b>	<b>61,999</b>	<b>2,210</b>	<b>904</b>	<b>65,113</b>
Provision for credit losses	6,864	2,380	—	9,244	3,270	2,210	—	5,480
<b>Noninterest expense</b>	<b>41,703</b>	<b>—</b>	<b>—</b>	<b>41,703</b>	<b>38,843</b>	<b>—</b>	<b>—</b>	<b>38,843</b>
<b>Income from continuing operations before income tax expense</b>	<b>22,805</b>	<b>—</b>	<b>1,060</b>	<b>23,865</b>	<b>19,886</b>	<b>—</b>	<b>904</b>	<b>20,790</b>
Income tax expense	7,440	—	1,060	8,500	6,237	—	904	7,141
<b>Income from continuing operations</b>	<b>15,365</b>	<b>—</b>	<b>—</b>	<b>15,365</b>	<b>13,649</b>	<b>—</b>	<b>—</b>	<b>13,649</b>
Income from discontinued operations	—	—	—	—	795	—	—	795
<b>Net income</b>	<b>\$ 15,365</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 15,365</b>	<b>\$ 14,444</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 14,444</b>
<b>Income from continuing operations – diluted earnings per share</b>	<b>\$ 4.38</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 4.38</b>	<b>\$ 3.82</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 3.82</b>
Return on common equity <sup>(a)</sup>	13%	—%	—%	13%	12%	—%	—%	12%
Return on common equity less goodwill <sup>(a)</sup>	21	—	—	21	20	—	—	20
Return on assets <sup>(a)</sup>	1.06	NM	NM	1.01	1.04	NM	NM	1.00
Overhead ratio	58	NM	NM	56	63	NM	NM	60
Loans—Period-end	\$ 519,374	\$ 72,701	\$ —	\$ 592,075	\$ 483,127	\$ 66,950	\$ —	\$ 550,077
Total assets – average	1,455,044	66,780	—	1,521,824	1,313,794	65,266	—	1,379,060

(a) Based on Income from continuing operations.

(b) The impact of credit card securitizations affects CS. See the segment discussion for CS on pages 49–51 of this Annual Report for further information.

and ongoing risk monitoring are used for both loans on the Consolidated balance sheets and securitized loans. Although securitizations result in the sale of credit card receivables to a trust, JPMorgan Chase retains the ongoing customer relationships, as the customers may continue to use their credit cards; accordingly, the customer's credit performance will affect both the securitized loans and the loans retained on the Consolidated balance sheets. JPMorgan Chase believes managed basis information is useful to investors, enabling them to understand both the credit risks associated with the loans reported on the Consolidated balance sheets and the Firm's retained interests in securitized loans. For a reconciliation of reported to managed basis results for CS, see CS segment results on pages 49–51 of this Annual Report. For information regarding the securitization process, and loans and residual interests sold and securitized, see Note 16 on pages 139–145 of this Annual Report.

Total net revenue for each of the business segments and the Firm is presented on an FTE basis. Accordingly, revenue from tax-exempt securities and investments that receive tax credits is presented in the managed results on a basis comparable to taxable securities and investments. This non-GAAP financial measure allows management to assess the comparability of revenue arising from both taxable and tax-exempt sources. The corresponding income tax impact related to these items is recorded within Income tax expense.

Management also uses certain other non-GAAP financial measures at the business segment level because it believes these other non-GAAP financial measures provide information to investors about the underlying operational performance and trends of the particular business segment and therefore facilitate a comparison of the business segment with the performance of its competitors.

(Table continued from previous page)

2005			
Reported results	Credit card <sup>(b)</sup>	Fully tax-equivalent adjustments	Managed basis
\$ 4,088	\$ —	\$ —	\$ 4,088
8,072	—	—	8,072
3,389	—	—	3,389
9,988	—	—	9,988
(1,336)	—	—	(1,336)
1,054	—	—	1,054
6,754	(2,718)	—	4,036
2,684	—	571	3,255
34,693	(2,718)	571	32,546
19,555	6,494	269	26,318
54,248	3,776	840	58,864
3,483	3,776	—	7,259
38,926	—	—	38,926
11,839	—	840	12,679
3,585	—	840	4,425
8,254	—	—	8,254
229	—	—	229
\$ 8,483	\$ —	\$ —	\$ 8,483
\$ 2.32	\$ —	\$ —	\$ 2.32
8%	—%	—%	8%
13	—	—	13
0.70	NM	NM	0.67
72	NM	NM	66
\$ 419,148	\$ 70,527	—	\$ 489,675
1,185,066	67,180	—	1,252,246

#### Calculation of certain U.S. GAAP and non-GAAP metrics

The table below reflects the formulas used to calculate both the following U.S. GAAP and non-GAAP measures:

##### Return on common equity

Net income\* / Average common stockholders' equity

##### Return on common equity less goodwill<sup>(a)</sup>

Net income\* / Average common stockholders' equity less goodwill

##### Return on assets

Reported Net income / Total average assets

Managed Net income / Total average managed assets<sup>(b)</sup>  
(including average securitized credit card receivables)

##### Overhead ratio

Total noninterest expense / Total net revenue

\* Represents Net income applicable to common stock

(a) The Firm uses Return on common equity less goodwill, a non-GAAP financial measure, to evaluate the operating performance of the Firm and to facilitate comparisons to competitors.

(b) The Firm uses Return on managed assets, a non-GAAP financial measure, to evaluate the overall performance of the managed credit card portfolio, including securitized credit card loans.

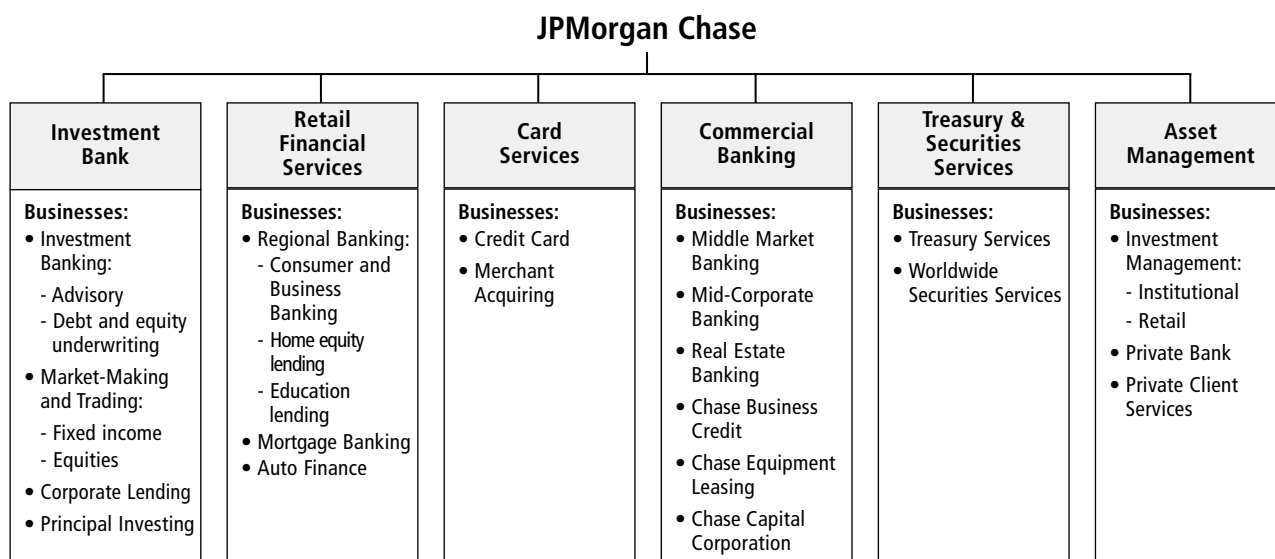
## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### BUSINESS SEGMENT RESULTS

The Firm is managed on a line-of-business basis. The business segment financial results presented reflect the current organization of JPMorgan Chase. There are six major reportable business segments: the Investment Bank, Retail Financial Services, Card Services, Commercial Banking, Treasury & Securities Services and Asset

Management, as well as a Corporate segment. The business segments are determined based upon the products and services provided, or the type of customer served, and they reflect the manner in which financial information is currently evaluated by management. Results of these lines of business are presented on a managed basis.



#### Description of business segment reporting methodology

Results of the business segments are intended to reflect each segment as if it were essentially a stand-alone business.

The management reporting process that derives business segment results allocates income and expense using market-based methodologies. The Firm continues to assess the assumptions, methodologies and reporting classifications used for segment reporting, and further refinements may be implemented in future periods. Business segment reporting methodologies used by the Firm are discussed below.

##### Revenue sharing

When business segments join efforts to sell products and services to the Firm's clients, the participating business segments agree to share revenue from those transactions. The segment results reflect these revenue-sharing agreements.

##### Funds transfer pricing

Funds transfer pricing is used to allocate interest income and expense to each business and transfer the primary interest rate risk exposures to Treasury within the Corporate business segment. The allocation process is unique to each business segment and considers the interest rate risk, liquidity risk and regulatory requirements of

that segment's stand-alone peers. This process is overseen by the Firm's Asset-Liability Committee ("ALCO"). Business segments may retain certain interest rate exposures, subject to management approval, that would be expected in the normal operation of a similar peer business.

##### Capital allocation

Each business segment is allocated capital by taking into consideration stand-alone peer comparisons, economic risk measures and regulatory capital requirements. The amount of capital assigned to each business is referred to as equity. Effective January 1, 2006, the Firm refined its methodology for allocating capital to the business segments. As the 2005 period was not revised to reflect the new capital allocations, certain business metrics, such as ROE, are not comparable to the presentations in 2007 and 2006. For a further discussion of this change, see Capital management—Line of business equity on page 63 of this Annual Report.

##### Expense allocation

Where business segments use services provided by support units within the Firm, the costs of those support units are allocated to the business segments. The expense is allocated based upon their actual cost or the lower of actual cost or market, as well as upon usage of the services provided. In contrast, certain other expense related to certain corporate functions, or to certain technology and operations,

are not allocated to the business segments and are retained in Corporate. Retained expense includes: parent company costs that would not be incurred if the segments were stand-alone businesses;

adjustments to align certain corporate staff, technology and operations allocations with market prices; and other one-time items not aligned with the business segments.

### Segment results – Managed basis<sup>(a)</sup>

The following table summarizes the business segment results for the periods indicated.

Year ended December 31, (in millions, except ratios)	Total net revenue			Noninterest expense		
	2007	2006	2005	2007	2006	2005
Investment Bank	<b>\$ 18,170</b>	\$ 18,833	\$ 15,110	<b>\$ 13,074</b>	\$ 12,860	\$ 10,246
Retail Financial Services	<b>17,479</b>	14,825	14,830	<b>9,900</b>	8,927	8,585
Card Services	<b>15,235</b>	14,745	15,366	<b>4,914</b>	5,086	4,999
Commercial Banking	<b>4,103</b>	3,800	3,488	<b>1,958</b>	1,979	1,856
Treasury & Securities Services	<b>6,945</b>	6,109	5,539	<b>4,580</b>	4,266	4,050
Asset Management	<b>8,635</b>	6,787	5,664	<b>5,515</b>	4,578	3,860
Corporate	<b>4,245</b>	14	(1,133)	<b>1,762</b>	1,147	5,330
<b>Total</b>	<b>\$ 74,812</b>	\$ 65,113	\$ 58,864	<b>\$ 41,703</b>	\$ 38,843	\$ 38,926

Year ended December 31, (in millions, except ratios)	Net income (loss)			Return on equity		
	2007	2006	2005	2007	2006	2005
Investment Bank	<b>\$ 3,139</b>	\$ 3,674	\$ 3,673	<b>15%</b>	18%	18%
Retail Financial Services	<b>3,035</b>	3,213	3,427	<b>19</b>	22	26
Card Services	<b>2,919</b>	3,206	1,907	<b>21</b>	23	16
Commercial Banking	<b>1,134</b>	1,010	951	<b>17</b>	18	28
Treasury & Securities Services	<b>1,397</b>	1,090	863	<b>47</b>	48	57
Asset Management	<b>1,966</b>	1,409	1,216	<b>51</b>	40	51
Corporate <sup>(b)</sup>	<b>1,775</b>	842	(3,554)	<b>NM</b>	NM	NM
<b>Total</b>	<b>\$ 15,365</b>	\$ 14,444	\$ 8,483	<b>13%</b>	13%	8%

(a) Represents reported results on a tax-equivalent basis and excludes the impact of credit card securitizations.

(b) Net income included Income from discontinued operations of zero, \$795 million and \$229 million for 2007, 2006 and 2005, respectively.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### INVESTMENT BANK

**JPMorgan is one of the world's leading investment banks, with deep client relationships and broad product capabilities. The Investment Bank's clients are corporations, financial institutions, governments and institutional investors. The Firm offers a full range of investment banking products and services in all major capital markets, including advising on corporate strategy and structure, capital raising in equity and debt markets, sophisticated risk management, market-making in cash securities and derivative instruments and research. The IB also commits the Firm's own capital to proprietary investing and trading activities.**

#### Selected income statement data

Year ended December 31, (in millions, except ratios)	2007	2006	2005
<b>Revenue</b>			
Investment banking fees	\$ 6,616	\$ 5,537	\$ 4,096
Principal transactions <sup>(a)</sup>	4,409	9,512	6,459
Lending & deposit-related fees	446	517	594
Asset management, administration and commissions	2,701	2,240	1,824
All other income <sup>(b)</sup>	(78)	528	534
<b>Noninterest revenue</b>	<b>14,094</b>	<b>18,334</b>	<b>13,507</b>
<b>Net interest income<sup>(c)</sup></b>	<b>4,076</b>	<b>499</b>	<b>1,603</b>
<b>Total net revenue<sup>(d)</sup></b>	<b>18,170</b>	<b>18,833</b>	<b>15,110</b>
Provision for credit losses	654	191	(838)
Credit reimbursement from TSS <sup>(e)</sup>	121	121	154
<b>Noninterest expense</b>			
Compensation expense	7,965	8,190	5,792
Noncompensation expense	5,109	4,670	4,454
<b>Total noninterest expense</b>	<b>13,074</b>	<b>12,860</b>	<b>10,246</b>
<b>Income before income tax expense</b>	<b>4,563</b>	<b>5,903</b>	<b>5,856</b>
Income tax expense	1,424	2,229	2,183
<b>Net income</b>	<b>\$ 3,139</b>	<b>\$ 3,674</b>	<b>\$ 3,673</b>
<b>Financial ratios</b>			
ROE	15%	18%	18%
ROA	0.45	0.57	0.61
Overhead ratio	72	68	68
Compensation expense as % of total net revenue <sup>(f)</sup>	44	41	38

(a) In 2007, as a result of adopting SFAS 157, IB recognized a benefit of \$1.3 billion in Principal transactions revenue from the widening of the Firm's credit spread for liabilities carried at fair value.

(b) All other income for 2007 decreased from the prior year due mainly to losses on loan sales and lower gains on sales of assets.

(c) Net interest income for 2007 increased from the prior year due primarily to an increase in interest earnings assets. The decline in net interest income in 2006 is largely driven by a decline in trading-related net interest income caused by a higher proportion of noninterest-bearing net trading assets to total net trading assets, higher funding costs compared with the prior year, and spread compression due to the inverted yield curve in place for most of 2006.

(d) Total Net revenue includes tax-equivalent adjustments, primarily due to tax-exempt income from municipal bond investments and income tax credits related to affordable housing investments, of \$927 million, \$802 million and \$752 million for 2007, 2006 and 2005, respectively.

(e) TSS was charged a credit reimbursement related to certain exposures managed within the IB credit portfolio on behalf of clients shared with TSS.

(f) For 2006, the Compensation expense to Total net revenue ratio is adjusted to present this ratio as if SFAS 123R had always been in effect. IB management believes that adjusting the Compensation expense to Total net revenue ratio for the incremental impact of adopting SFAS 123R provides a more meaningful measure of IB's Compensation expense to Total net revenue ratio.

The following table provides the IB's Total net revenue by business segment.

Year ended December 31, (in millions)	2007	2006	2005
<b>Revenue by business</b>			
Investment banking fees:			
Advisory	\$ 2,273	\$ 1,659	\$ 1,263
Equity underwriting	1,713	1,178	864
Debt underwriting	2,630	2,700	1,969
<b>Total investment banking fees</b>	<b>6,616</b>	<b>5,537</b>	<b>4,096</b>
Fixed income markets <sup>(a)(b)</sup>	6,339	8,736	7,570
Equity markets <sup>(a)(c)</sup>	3,903	3,458	1,998
Credit portfolio <sup>(a)(d)</sup>	1,312	1,102	1,446
<b>Total net revenue</b>	<b>\$ 18,170</b>	<b>\$ 18,833</b>	<b>\$ 15,110</b>

(a) In 2007, as a result of adopting SFAS 157, Fixed income markets, Equity markets and Credit portfolio had a benefit of \$541 million, \$346 million and \$433 million, respectively, from the widening of the Firm's credit spread for liabilities carried at fair value.

(b) Fixed income markets include client and portfolio management revenue related to both market-making and proprietary risk-taking across global fixed income markets, including foreign exchange, interest rate, credit and commodities markets.

(c) Equities markets include client and portfolio management revenue related to market-making and proprietary risk-taking across global equity products, including cash instruments, derivatives and convertibles.

(d) Credit portfolio revenue includes Net interest income, fees and loan sale activity, as well as gains or losses on securities received as part of a loan restructuring, for the IB's credit portfolio. Credit portfolio revenue also includes the results of risk management related to the Firm's lending and derivative activities, and changes in the credit valuation adjustment, which is the component of the fair value of a derivative that reflects the credit quality of the counterparty. See pages 80–82 of the Credit risk management section of this Annual Report for further discussion.

#### 2007 compared with 2006

Net income was \$3.1 billion, a decrease of \$535 million, or 15%, from the prior year. The decrease reflected lower fixed income revenue, a higher provision for credit losses and increased noninterest expense, partially offset by record investment banking fees and equity markets revenue.

Total net revenue was \$18.2 billion, down \$663 million, or 4%, from the prior year. Investment banking fees were \$6.6 billion, up 19% from the prior year, driven by record fees across advisory and equity underwriting, partially offset by lower debt underwriting fees. Advisory fees were \$2.3 billion, up 37%, and equity underwriting fees were \$1.7 billion, up 45%; both were driven by record performance across all regions. Debt underwriting fees of \$2.6 billion declined 3%, reflecting lower loan syndication and bond underwriting fees, which were negatively affected by market conditions in the second half of the year. Fixed Income Markets revenue decreased 27% from the prior year. The decrease was due to markdowns of \$1.4 billion (net of hedges) on subprime positions, including subprime CDOs and markdowns of \$1.3 billion (net of fees) on leverage lending funded loans and unfunded commitments. Fixed Income Markets revenue also decreased due to markdowns in securitized products on non-subprime mortgages and weak credit trading performance. These lower results were offset partially by record revenue in currencies and strong revenue in rates. Equity Markets revenue was \$3.9 billion, up 13%, benefiting from strong client activity and record trading results across all

products. Credit Portfolio revenue was \$1.3 billion, up 19%, primarily due to higher revenue from risk management activities, partially offset by lower gains from loan sales and workouts.

The Provision for credit losses was \$654 million, an increase of \$463 million from the prior year. The change was due to a net increase of \$532 million in the Allowance for credit losses, primarily due to portfolio activity, which included the effect of the weakening credit environment, and an increase in allowance for unfunded leveraged lending commitments, as well as portfolio growth. In addition, there were \$36 million of net charge-offs in the current year, compared with \$31 million of net recoveries in the prior year. The Allowance for loan losses to average loans was 2.14% for 2007, compared with a ratio of 1.79% in the prior year.

Noninterest expense was \$13.1 billion, up \$214 million, or 2%, from the prior year.

Return on equity was 15% on \$21.0 billion of allocated capital compared with 18% on \$20.8 billion in 2006.

### 2006 compared with 2005

Net income of \$3.7 billion was flat, as record revenue of \$18.8 billion was offset largely by higher compensation expense, including the impact of SFAS 123R, and Provision for credit losses compared with a benefit in the prior year.

Total net revenue of \$18.8 billion was up \$3.7 billion, or 25%, from the prior year. Investment banking fees of \$5.5 billion were a record, up 35% from the prior year, driven by record debt and equity underwriting as well as strong advisory fees, which were the highest since 2000. Advisory fees of \$1.7 billion were up 31% over the prior year driven primarily by strong performance in the Americas. Debt underwriting fees of \$2.7 billion were up 37% from the prior year driven by record performance in both loan syndications and bond underwriting. Equity underwriting fees of \$1.2 billion were up 36% from the prior year driven by global equity markets. Fixed Income Markets revenue of \$8.7 billion was also a record, up 15% from the prior year driven by strength in credit markets, emerging markets and currencies. Record Equity Markets revenue of \$3.5 billion increased 73%, and was driven by strength in cash equities and equity derivatives. Credit Portfolio revenue of \$1.1 billion was down 24%, primarily reflecting lower gains from loan workouts.

Provision for credit losses was \$191 million compared with a benefit of \$838 million in the prior year. The 2006 provision reflects portfolio activity; credit quality remained stable. The prior-year benefit reflected strong credit quality, a decline in criticized and nonperforming loans and a higher level of recoveries.

Total noninterest expense of \$12.9 billion was up \$2.6 billion, or 26%, from the prior year. This increase was due primarily to higher performance-based compensation, including the impact of an increase in the ratio of compensation expense to total net revenue, as well as the incremental expense related to SFAS 123R.

Return on equity was 18% on \$20.8 billion of allocated capital compared with 18% on \$20.0 billion in 2005.

### Selected metrics

Year ended December 31,  
(in millions, except headcount)

	2007	2006	2005
<b>Revenue by region</b>			
Americas	\$ 8,165	\$ 9,601	\$ 8,462
Europe/Middle East/Africa	7,301	7,421	4,871
Asia/Pacific	2,704	1,811	1,777
<b>Total net revenue</b>	<b>\$ 18,170</b>	<b>\$ 18,833</b>	<b>\$ 15,110</b>
<b>Selected average balances</b>			
Total assets	\$ 700,565	\$ 647,569	\$ 599,761
Trading assets—debt and equity instruments <sup>(a)</sup>	359,775	275,077	231,303
Trading assets—derivative receivables	63,198	54,541	55,239
Loans:			
Loans retained <sup>(b)</sup>	62,247	58,846	44,813
Loans held-for-sale and loans at fair value <sup>(a)</sup>	17,723	21,745	11,755
<b>Total loans</b>	<b>79,970</b>	<b>80,591</b>	<b>56,568</b>
Adjusted assets <sup>(c)</sup>	611,749	527,753	456,920
Equity	21,000	20,753	20,000
<b>Headcount</b>	<b>25,543#</b>	<b>23,729#</b>	<b>19,802#</b>

(a) As a result of the adoption of SFAS 159 in the first quarter of 2007, \$11.7 billion of loans were reclassified to trading assets. Loans held-for-sale and loans at fair value were excluded when calculating the allowance coverage ratio and net charge-off (recovery) rate.

(b) Loans retained included credit portfolio loans, leveraged leases and other accrual loans, and excluded loans at fair value.

(c) Adjusted assets, a non-GAAP financial measure, equals Total assets minus (1) Securities purchased under resale agreements and Securities borrowed less Securities sold, not yet purchased; (2) assets of variable interest entities ("VIEs") consolidated under FIN 46R; (3) cash and securities segregated and on deposit for regulatory and other purposes; and (4) goodwill and intangibles. The amount of adjusted assets is presented to assist the reader in comparing IB's asset and capital levels to other investment banks in the securities industry. Asset-to-equity leverage ratios are commonly used as one measure to assess a company's capital adequacy. IB believes an adjusted asset amount that excludes the assets discussed above, which were considered to have a low risk profile, provide a more meaningful measure of balance sheet leverage in the securities industry.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### Selected metrics

Year ended December 31,  
(in millions, except ratio data)

	2007	2006	2005
<b>Credit data and quality statistics</b>			
Net charge-offs (recoveries)	\$ 36	\$ (31)	\$ (126)
Nonperforming assets: <sup>(a)</sup>			
Nonperforming loans	353	231	594
Other nonperforming assets	100	38	51
Allowance for credit losses:			
Allowance for loan losses	1,329	1,052	907
Allowance for lending-related commitments	560	305	226
Total Allowance for credit losses	1,889	1,357	1,133
Net charge-off (recovery) rate <sup>(b)(c)</sup>	0.06%	(0.05)%	(0.28)%
Allowance for loan losses to average loans <sup>(b)(c)</sup>	2.14 <sup>(e)</sup>	1.79	2.02
Allowance for loan losses to nonperforming loans <sup>(a)</sup>	431	461	187
Nonperforming loans to average loans	0.44	0.29	1.05
<b>Market risk—average trading and credit portfolio VAR<sup>(d)</sup></b>			
Trading activities:			
Fixed income	\$ 80	\$ 56	\$ 67
Foreign exchange	23	22	23
Equities	48	31	34
Commodities and other	33	45	21
Less: portfolio diversification	(77)	(70)	(59)
<b>Total trading VAR</b>	<b>107</b>	<b>84</b>	<b>86</b>
Credit portfolio VAR	17	15	14
Less: portfolio diversification	(18)	(11)	(12)
<b>Total trading and credit portfolio VAR</b>	<b>\$ 106</b>	<b>\$ 88</b>	<b>\$ 88</b>

(a) Nonperforming loans included loans held-for-sale of \$45 million, \$3 million and \$109 million at December 31, 2007, 2006 and 2005, respectively, which were excluded from the allowance coverage ratios. Nonperforming loans excluded distressed loans held-for-sale that were purchased as part of IB's proprietary activities.

(b) As a result of the adoption of SFAS 159 in the first quarter of 2007, \$11.7 billion of loans were reclassified to trading assets. Loans held-for-sale and loans at fair value were excluded when calculating the allowance coverage ratio and net charge-off (recovery) rate.

(c) Loans retained included credit portfolio loans, leveraged leases and other accrual loans, and excluded loans at fair value.

(d) For a more complete description of VAR, see page 91 of this Annual Report.

(e) The allowance for loan losses to period-end loans was 1.92% at December 31, 2007.

### Market shares and rankings<sup>(a)</sup>

December 31,	2007		2006		2005	
	Market Share	Rankings	Market Share	Rankings	Market Share	Rankings
Global debt, equity and equity-related	7%	#2	7%	#2	7%	#2
Global syndicated loans	13	1	14	1	15	1
Global long-term debt	7	2	6	3	6	4
Global equity and equity-related	9	2	7	6	7	6
Global announced M&A	24	4	26	4	23	3
U.S. debt, equity and equity-related	10	2	9	2	8	3
U.S. syndicated loans	24	1	26	1	28	1
U.S. long-term debt	12	2	12	2	11	2
U.S. equity and equity-related <sup>(b)</sup>	11	5	8	6	9	6
U.S. announced M&A	25	4	29	3	26	3

(a) Source: Thomson Financial Securities data. Global announced M&A is based upon rank value; all other rankings are based upon proceeds, with full credit to each book manager/equal if joint. Because of joint assignments, market share of all participants will add up to more than 100%; Global and U.S. announced M&A market share and ranking for 2006 include transactions withdrawn since December 31, 2006.

(b) References U.S. domiciled equity and equity-related transactions, per Thomson Financial.

According to Thomson Financial, in 2007, the Firm maintained its #2 position in Global Debt, Equity and Equity-related, its #1 position in Global Syndicated Loans and its #4 position in Global Announced M&A. The Firm improved its position to #2 in Global Equity & Equity-related transactions and Global Long-term Debt.

According to Dealogic, the Firm was ranked #1 in Investment Banking fees generated during 2007, based upon revenue.

## RETAIL FINANCIAL SERVICES

**Retail Financial Services, which includes the Regional Banking, Mortgage Banking and Auto Finance reporting segments, serves consumers and businesses through bank branches, ATMs, online banking and telephone banking. Customers can use more than 3,100 bank branches (fourth-largest nationally), 9,100 ATMs (third-largest nationally) and 290 mortgage offices. More than 13,700 branch salespeople assist customers with checking and savings accounts, mortgages, home equity and business loans and investments across the 17-state footprint from New York to Arizona. Consumers also can obtain loans through more than 14,500 auto dealerships and 5,200 schools and universities nationwide.**

During the first quarter of 2006, RFS completed the purchase of Collegiate Funding Services, which contributed an education loan servicing capability and provided an entry into the Federal Family Education Loan Program consolidation market. On July 1, 2006, RFS sold its life insurance and annuity underwriting businesses to Protective Life Corporation. On October 1, 2006, JPMorgan Chase completed the Bank of New York transaction, significantly strengthening RFS's distribution network in the New York tri-state area.

### Selected income statement data

Year ended December 31,

(in millions, except ratios)

	2007	2006	2005
<b>Revenue</b>			
Lending & deposit-related fees	\$ 1,881	\$ 1,597	\$ 1,452
Asset management, administration and commissions	1,275	1,422	1,498
Securities gains (losses)	1	(57)	9
Mortgage fees and related income <sup>(a)</sup>	2,094	618	1,104
Credit card income	646	523	426
Other income	906	557	136
<b>Noninterest revenue</b>	<b>6,803</b>	<b>4,660</b>	<b>4,625</b>
<b>Net interest income</b>	<b>10,676</b>	<b>10,165</b>	<b>10,205</b>
<b>Total net revenue</b>	<b>17,479</b>	<b>14,825</b>	<b>14,830</b>
Provision for credit losses	2,610	561	724
<b>Noninterest expense</b>			
Compensation expense <sup>(a)</sup>	4,369	3,657	3,337
Noncompensation expense <sup>(a)</sup>	5,066	4,806	4,748
Amortization of intangibles	465	464	500
<b>Total noninterest expense</b>	<b>9,900</b>	<b>8,927</b>	<b>8,585</b>
<b>Income before income tax expense</b>	<b>4,969</b>	<b>5,337</b>	<b>5,521</b>
Income tax expense	1,934	2,124	2,094
<b>Net income</b>	<b>\$ 3,035</b>	<b>\$ 3,213</b>	<b>\$ 3,427</b>
<b>Financial ratios</b>			
ROE	19%	22%	26%
Overhead ratio <sup>(a)</sup>	57	60	58
Overhead ratio excluding core deposit intangibles <sup>(a)(b)</sup>	54	57	55

(a) The Firm adopted SFAS 159 in the first quarter of 2007. As a result, certain loan-origination costs have been classified as expense (previously netted against revenue) for the year ended December 31, 2007.

(b) Retail Financial Services uses the overhead ratio (excluding the amortization of core deposit intangibles ("CDI")), a non-GAAP financial measure, to evaluate the underlying expense trends of the business. Including CDI amortization expense in the overhead ratio calculation results in a higher overhead ratio in the earlier years and a lower overhead ratio in later years; this method would result in an improving overhead ratio over time, all things remaining equal. This non-GAAP ratio excludes Regional Banking's core deposit intangible amortization expense related to The Bank of New York transaction and the Bank One merger of \$460 million, \$458 million and \$496 million for the years ended December 31, 2007, 2006 and 2005, respectively.

### 2007 compared with 2006

Net income was \$3.0 billion, a decrease of \$178 million, or 6%, from the prior year, as declines in Regional Banking and Auto Finance were offset partially by improved results in Mortgage Banking.

Total net revenue was \$17.5 billion, an increase of \$2.7 billion, or 18%, from the prior year. Net interest income was \$10.7 billion, up \$511 million, or 5%, due to the Bank of New York transaction, wider loan spreads and higher deposit balances. These benefits were offset partially by the sale of the insurance business and a shift to narrower-spread deposit products. Noninterest revenue was \$6.8 billion, up \$2.1 billion, benefiting from valuation adjustments to the MSR asset; an increase in deposit-related fees; the absence of a prior-year \$233 million loss related to \$13.3 billion of mortgage loans transferred to held-for-sale; and increased mortgage loan servicing revenue. Noninterest revenue also benefited from the classification of certain mortgage loan origination costs as expense (loan origination costs previously netted against revenue commenced being recorded as an expense in the first quarter of 2007 due to the adoption of SFAS 159).

The Provision for credit losses was \$2.6 billion, compared with \$561 million in the prior year. The current-year provision includes a net increase of \$1.0 billion in the Allowance for loan losses related to home equity loans as continued weak housing prices have resulted in an increase in estimated losses for high loan-to-value loans. Home equity net charge-offs were \$564 million (0.62% net charge-off rate), compared with \$143 million (0.18% net charge-off rate) in the prior year. In addition, the current-year provision includes a \$166 million increase in the allowance for loan losses related to subprime mortgage loans, reflecting an increase in estimated losses and growth in the portfolio. Subprime mortgage net charge-offs were \$157 million (1.55% net charge-off rate), compared with \$47 million (0.34% net charge-off rate) in the prior year.

Noninterest expense was \$9.9 billion, an increase of \$973 million, or 11%, from the prior year due to the Bank of New York transaction; the classification of certain loan origination costs as expense due to the adoption of SFAS 159; investments in the retail distribution network; and higher mortgage production and servicing expense. These increases were offset partially by the sale of the insurance business.

### 2006 compared with 2005

Net income of \$3.2 billion was down \$214 million, or 6%, from the prior year. A decline in Mortgage Banking was offset partially by improved results in Regional Banking and Auto Finance.

Total net revenue of \$14.8 billion was flat compared with the prior year. Net interest income of \$10.2 billion was down slightly due to narrower spreads on loans and deposits in Regional Banking, lower auto

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

loan and lease balances and the sale of the insurance business. These declines were offset by the benefit of higher deposit and loan balances in Regional Banking, wider loan spreads in Auto Finance and the Bank of New York transaction. Noninterest revenue of \$4.7 billion was up \$35 million, or 1%, from the prior year. Results benefited from increases in deposit-related and branch production fees, higher automobile operating lease revenue and the Bank of New York transaction. This benefit was offset by lower net mortgage servicing revenue, the sale of the insurance business and losses related to loans transferred to held-for-sale. In 2006, losses of \$233 million, compared with losses of \$120 million in 2005, were recognized in Regional Banking related to mortgage loans transferred to held-for-sale; and losses of \$50 million, compared with losses of \$136 million in the prior year, were recognized in Auto Finance related to automobile loans transferred to held-for-sale.

The Provision for credit losses of \$561 million was down \$163 million from the prior-year provision due to the absence of a \$250 million special provision for credit losses related to Hurricane Katrina in the prior year, partially offset by the establishment of additional allowance for loan losses related to loans acquired from The Bank of New York.

Total noninterest expense of \$8.9 billion was up \$342 million, or 4%, primarily due to the Bank of New York transaction, the acquisition of Collegiate Funding Services, investments in the retail distribution network and higher depreciation expense on owned automobiles subject to operating leases. These increases were offset partially by the sale of the insurance business and merger-related and other operating efficiencies and the absence of a \$40 million prior-year charge related to the dissolution of an education loan joint venture.

### Selected metrics

Year ended December 31,  
(in millions, except headcount  
and ratios)

	2007	2006	2005
<b>Selected ending balances</b>			
Assets	<b>\$ 225,908</b>	\$ 237,887	\$ 224,801
Loans:			
Loans retained	<b>181,016</b>	180,760	180,701
Loans held-for-sale and loans at fair value <sup>(a)</sup>	<b>16,541</b>	32,744	16,598
Total Loans	<b>197,557</b>	213,504	197,299
Deposits	<b>221,129</b>	214,081	191,415
<b>Selected average balances</b>			
Assets	<b>\$ 217,564</b>	\$ 231,566	\$ 226,368
Loans:			
Loans retained	<b>168,166</b>	187,753	182,478
Loans held-for-sale and loans at fair value <sup>(a)</sup>	<b>22,587</b>	16,129	15,675
Total Loans	<b>190,753</b>	203,882	198,153
Deposits	<b>218,062</b>	201,127	186,811
Equity	<b>16,000</b>	14,629	13,383
<b>Headcount</b>	<b>69,465#</b>	65,570#	60,998#
<b>Credit data and quality statistics</b>			
Net charge-offs	<b>\$ 1,327</b>	\$ 576	\$ 572
Nonperforming loans <sup>(b)(c)</sup>	<b>2,704</b>	1,677	1,338
Nonperforming assets <sup>(b)(c)</sup>	<b>3,190</b>	1,902	1,518
Allowance for loan losses	<b>2,634</b>	1,392	1,363
Net charge-off rate <sup>(d)</sup>	<b>0.79%</b>	0.31%	0.31%
Allowance for loan losses to ending loans <sup>(d)</sup>	<b>1.46</b>	0.77	0.75
Allowance for loan losses to nonperforming loans <sup>(d)</sup>	<b>100</b>	89	104
Nonperforming loans to total loans	<b>1.37</b>	0.79	0.68

(a) Loans included prime mortgage loans originated with the intent to sell, which, for new originations on or after January 1, 2007, were accounted for at fair value under SFAS 159. These loans, classified as Trading assets on the Consolidated balance sheets, totaled \$12.6 billion at December 31, 2007. Average Loans included prime mortgage loans, classified as Trading assets on the Consolidated balance sheets, of \$11.9 billion for the year ended December 31, 2007.

(b) Nonperforming loans included Loans held-for-sale and Loans accounted for at fair value under SFAS 159 of \$69 million, \$116 million and \$27 million at December 31, 2007, 2006 and 2005, respectively. Certain of these loans are classified as Trading assets on the Consolidated balance sheet.

(c) Nonperforming loans and assets excluded (1) loans eligible for repurchase as well as loans repurchased from Governmental National Mortgage Association ("GNMA") pools that are insured by U.S. government agencies of \$1.5 billion, \$1.2 billion and \$1.1 billion at December 31, 2007, 2006 and 2005, respectively, and (2) education loans that are 90 days past due and still accruing, which are insured by U.S. government agencies under the Federal Family Education Loan Program of \$279 million and \$219 million at December 31, 2007 and 2006, respectively. The education loans past due 90 days were insignificant at December 31, 2005. These amounts for GNMA and education loans were excluded, as reimbursement is proceeding normally.

(d) Loans held-for-sale and Loans accounted for at fair value under SFAS 159 were excluded when calculating the allowance coverage ratio and the Net charge-off rate.

## Regional Banking

### Selected income statement data

Year ended December 31, (in millions, except ratios)	2007	2006	2005
Noninterest revenue	\$ 3,723	\$ 3,204	\$ 3,138
Net interest income	9,283	8,768	8,531
<b>Total net revenue</b>	<b>13,006</b>	11,972	11,669
Provision for credit losses	2,216	354	512
Noninterest expense	7,023	6,825	6,675
<b>Income before income tax expense</b>	<b>3,767</b>	4,793	4,482
<b>Net income</b>	<b>\$ 2,301</b>	\$ 2,884	\$ 2,780
ROE	20%	27%	31%
Overhead ratio	54	57	57
Overhead ratio excluding core deposit intangibles <sup>(a)</sup>	50	53	53

(a) Regional Banking uses the overhead ratio (excluding the amortization of CDI), a non-GAAP financial measure, to evaluate the underlying expense trends of the business. Including CDI amortization expense in the overhead ratio calculation results in a higher overhead ratio in the earlier years and a lower overhead ratio in later years; this method would result in an improving overhead ratio over time, all things remaining equal. This non-GAAP ratio excludes Regional Banking's core deposit intangible amortization expense related to the Bank of New York transaction and the Bank One merger of \$460 million, \$458 million and \$496 million for the years ended December 31, 2007, 2006 and 2005, respectively.

### 2007 compared with 2006

Regional Banking net income was \$2.3 billion, a decrease of \$583 million, or 20%, from the prior year. Total net revenue was \$13.0 billion, up \$1.0 billion, or 9%, benefiting from the following: the Bank of New York transaction; increased deposit-related fees; the absence of a prior-year \$233 million loss related to \$13.3 billion of mortgage loans transferred to held-for-sale; growth in deposits; and wider loan spreads. These benefits were offset partially by the sale of the insurance business and a shift to narrower-spread deposit products. The Provision for credit losses was \$2.2 billion, compared with \$354 million in the prior year. The increase in the provision was due to the home equity and subprime mortgage portfolios (see Retail Financial Services discussion of the Provision for credit losses for further detail). Noninterest expense was \$7.0 billion, up \$198 million, or 3%, from the prior year, as the Bank of New York transaction and investments in the retail distribution network were offset partially by the sale of the insurance business.

### 2006 compared with 2005

Regional Banking Net income of \$2.9 billion was up \$104 million from the prior year. Total net revenue of \$12.0 billion was up \$303 million, or 3%, including the impact of a \$233 million 2006 loss resulting from \$13.3 billion of mortgage loans transferred to held-for-sale and a prior-year loss of \$120 million resulting from \$3.3 billion of mortgage loans transferred to held-for-sale. Results benefited from the Bank of New York transaction; the acquisition of Collegiate Funding Services; growth in deposits and home equity loans; and increases in deposit-related fees and credit card sales. These benefits were offset partially by the sale of the insurance business, narrower spreads on loans, and a shift to narrower-spread deposit products. The Provision for credit losses decreased \$158 million, primarily the result of a \$230 million special provision in the prior year related to Hurricane Katrina, which was offset partially by addi-

tional Allowance for loan losses related to the acquisition of loans from The Bank of New York and increased net charge-offs due to portfolio seasoning and deterioration in subprime mortgages. Noninterest expense of \$6.8 billion was up \$150 million, or 2%, from the prior year. The increase was due to investments in the retail distribution network, the Bank of New York transaction and the acquisition of Collegiate Funding Services, partially offset by the sale of the insurance business, merger savings and operating efficiencies, and the absence of a \$40 million prior-year charge related to the dissolution of an education loan joint venture.

### Selected metrics

Year ended December 31,  
(in millions, except ratios and  
where otherwise noted)

	2007	2006	2005
<b>Business metrics (in billions)</b>			
<b>Selected ending balances</b>			
Home equity origination volume	\$ 48.3	\$ 51.9	\$ 54.1
End-of-period loans owned			
Home equity	\$ 94.8	\$ 85.7	\$ 73.9
Mortgage <sup>(a)</sup>	15.7	30.1	44.6
Business banking	15.4	14.1	12.8
Education	11.0	10.3	3.0
Other loans <sup>(b)</sup>	2.3	2.7	2.6
<b>Total end-of-period loans</b>	<b>139.2</b>	142.9	136.9
End-of-period deposits			
Checking	\$ 67.0	\$ 68.7	\$ 64.9
Savings	96.0	92.4	87.7
Time and other	48.7	43.3	29.7
<b>Total end-of-period deposits</b>	<b>211.7</b>	204.4	182.3
Average loans owned			
Home equity	\$ 90.4	\$ 78.3	\$ 69.9
Mortgage <sup>(a)</sup>	10.3	45.1	45.4
Business banking	14.7	13.2	12.6
Education	10.5	8.3	2.8
Other loans <sup>(b)</sup>	2.5	2.6	3.1
<b>Total average loans<sup>(c)</sup></b>	<b>128.4</b>	147.5	133.8
Average deposits			
Checking	\$ 66.0	\$ 62.8	\$ 61.7
Savings	97.1	89.9	87.5
Time and other	43.8	37.5	26.1
<b>Total average deposits</b>	<b>206.9</b>	190.2	175.3
Average assets	140.4	160.8	150.8
Average equity	11.8	10.5	9.1

### Credit data and quality statistics

30+ day delinquency rate <sup>(d)(e)</sup>	3.03%	2.02%	1.68%
Net charge-offs			
Home equity	\$ 564	\$ 143	\$ 141
Mortgage	159	56	25
Business banking	126	91	101
Other loans	116	48	28
<b>Total net charge-offs</b>	<b>965</b>	338	295
Net charge-off rate			
Home equity	0.62%	0.18%	0.20%
Mortgage <sup>(f)</sup>	1.52	0.12	0.06
Business banking	0.86	0.69	0.80
Other loans	1.26	0.59	0.93
<b>Total net charge-off rate<sup>(c)(f)</sup></b>	<b>0.77</b>	0.23	0.23
Nonperforming assets <sup>(g)</sup>	\$ 2,879	\$ 1,714	\$ 1,282

(a) As of January 1, 2007, \$19.4 billion of held-for-investment prime mortgage loans were transferred from RFS to Treasury within the Corporate segment for risk man-

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

agement and reporting purposes. The transfer had no impact on the financial results of Regional Banking. Balances reported at December 31, 2007 primarily reflected subprime mortgage loans owned.

- (b) Included commercial loans derived from community development activities and, prior to July 1, 2006, insurance policy loans.
- (c) Average loans included loans held-for-sale of \$3.8 billion, \$2.8 billion and \$2.9 billion for the years ended December 31, 2007, 2006 and 2005, respectively. These amounts were excluded when calculating in the Net charge-off rate.
- (d) Excluded loans eligible for repurchase as well as loans repurchased from GNMA pools that are insured by U.S. government agencies of \$1.2 billion, \$960 million, and \$896 million at December 31, 2007, 2006 and 2005, respectively. These amounts are excluded as reimbursement is proceeding normally.
- (e) Excluded loans that are 30 days past due and still accruing, which are insured by U.S. government agencies under the Federal Family Education Loan Program of \$663 million and \$464 million at December 31, 2007 and 2006, respectively. The education loans past due 30 days were insignificant at December 31, 2005. These amounts are excluded as reimbursement is proceeding normally.
- (f) The Mortgage and Total net charge-off rate for 2007, excluded \$2 million of charge-offs related to prime mortgage loans held by Treasury in the Corporate sector.
- (g) Excluded nonperforming assets related to education loans that are 90 days past due and still accruing, which are insured by U.S. government agencies under the Federal Family Education Loan Program of \$279 million and \$219 million at December 31, 2007 and 2006, respectively. The Education loans past due 90 days were insignificant at December 31, 2005. These amounts were excluded as reimbursement is proceeding normally.

### Retail branch business metrics

Year ended December 31,  
(in millions, except  
where otherwise noted)

	2007	2006	2005
Investment sales volume	\$ 18,360	\$ 14,882	\$ 11,144
<b>Number of:</b>			
Branches	3,152#	3,079#	2,641#
ATMs	9,186	8,506	7,312
Personal bankers <sup>(a)</sup>	9,650	7,573	7,067
Sales specialists <sup>(a)</sup>	4,105	3,614	3,214
Active online customers (in thousands) <sup>(b)</sup>	5,918	4,909	3,756
Checking accounts (in thousands)	10,839	9,995	8,793

- (a) Employees acquired as part of the Bank of New York transaction are included beginning in 2007.
- (b) During 2007, RFS changed the methodology for determining active online customers to include all individual RFS customers with one or more online accounts who have been active within 90 days of period end, including customers who also have online accounts with Card Services. Prior periods have been revised to conform to this new methodology.

### The following is a brief description of selected terms used by Regional Banking.

- **Personal bankers** – Retail branch office personnel who acquire, retain and expand new and existing customer relationships by assessing customer needs and recommending and selling appropriate banking products and services.
- **Sales specialists** – Retail branch office personnel who specialize in the marketing of a single product, including mortgages, investments, and business banking, by partnering with the personal bankers.

## Mortgage Banking

### Selected income statement data

Year ended December 31,

(in millions, except ratios and where  
otherwise noted)

	2007	2006	2005
Production revenue <sup>(a)</sup>	\$ 1,360	\$ 833	\$ 744
Net mortgage servicing revenue:			
Servicing revenue	2,510	2,300	2,115
Changes in MSR asset fair value:			
Due to inputs or assumptions in model	(516)	165	770
Other changes in fair value	(1,531)	(1,440)	(1,295)
Total changes in MSR asset fair value	(2,047)	(1,275)	(525)
Derivative valuation adjustments and other	879	(544)	(494)
<b>Total net mortgage servicing revenue</b>	<b>1,342</b>	<b>481</b>	<b>1,096</b>
<b>Total net revenue</b>	<b>2,702</b>	<b>1,314</b>	<b>1,840</b>
Noninterest expense <sup>(a)</sup>	1,987	1,341	1,239

**Income (loss) before income tax  
expense**

**715** (27) 601

**Net income (loss)** \$ **439** \$ (17) \$ 379

ROE **22%** NM 24%

### Business metrics (in billions)

Third-party mortgage loans serviced (ending)	\$ 614.7	\$ 526.7	\$ 467.5
MSR net carrying value (ending)	8.6	7.5	6.5
Average mortgage loans held-for-sale <sup>(b)</sup>	18.8	12.8	12.1
Average assets	33.9	25.8	22.4
Average equity	2.0	1.7	1.6

### Mortgage origination volume by channel<sup>(c)</sup> (in billions)

Retail	\$ 45.5	\$ 40.5	\$ 46.3
Wholesale	42.7	32.8	34.2
Correspondent	27.9	13.3	14.1
CNT (negotiated transactions)	43.3	32.6	34.4
<b>Total</b>	<b>\$ 159.4</b>	<b>\$ 119.2</b>	<b>\$ 129.0</b>

- (a) The Firm adopted SFAS 159 in the first quarter of 2007. As a result, certain loan origination costs have been classified as expense (previously netted against revenue) for the year ended December 31, 2007.
- (b) Included \$11.9 billion of prime mortgage loans at fair value for the year ended December 31, 2007. These loans are classified as Trading assets on the Consolidated balance sheet for 2007.
- (c) During the second quarter of 2007, RFS changed its definition of mortgage originations to include all newly originated mortgage loans sourced through RFS channels, and to exclude all mortgage loan originations sourced through IB channels. Prior periods have been revised to conform to this new definition.

### 2007 compared with 2006

Mortgage Banking Net income was \$439 million, compared with a net loss of \$17 million in the prior year. Total net revenue was \$2.7 billion, up \$1.4 billion. Total net revenue comprises production revenue and net mortgage servicing revenue. Production revenue was \$1.4 billion, up \$527 million, benefiting from an increase in mortgage loan originations and the classification of certain loan origination costs as expense (loan origination costs previously netted against revenue commenced being recorded as an expense in the first quarter of 2007 due to the adoption of SFAS 159). These bene-

fits were offset partially by markdowns of \$241 million on the mortgage warehouse and pipeline. Net mortgage servicing revenue, which includes loan servicing revenue, MSR risk management results and other changes in fair value, was \$1.3 billion, compared with \$481 million in the prior year. Loan servicing revenue of \$2.5 billion increased \$210 million on 17% growth in third-party loans serviced. MSR risk management revenue of \$363 million improved \$742 million from the prior year, reflecting a \$499 million current-year positive valuation adjustment to the MSR asset due to a decrease in estimated future mortgage prepayments; and the absence of a \$235 million prior-year negative valuation adjustment to the MSR asset. Other changes in fair value of the MSR asset were negative \$1.5 billion compared with negative \$1.4 billion in the prior year. Noninterest expense was \$2.0 billion, an increase of \$646 million, or 48%. The increase reflected the classification of certain loan origination costs due to the adoption of SFAS 159, higher servicing costs due to increased delinquencies and defaults, and higher production expense due partly to growth in originations.

#### **2006 compared with 2005**

Mortgage Banking Net loss was \$17 million compared with net income of \$379 million in the prior year. Total net revenue of \$1.3 billion was down \$526 million from the prior year due to a decline in net mortgage servicing revenue offset partially by an increase in production revenue. Production revenue was \$833 million, up \$89 million, reflecting increased loan sales and wider gain on sale margins that benefited from a shift in the sales mix. Net mortgage servicing revenue, which includes loan servicing revenue, MSR risk management results and other changes in fair value, was \$481 million compared with \$1.1 billion in the prior year. Loan servicing revenue of \$2.3 billion increased \$185 million on a 13% increase in third-party loans serviced. MSR risk management revenue of negative \$379 million was down \$655 million from the prior year, including the impact of a \$235 million negative valuation adjustment to the MSR asset in the third quarter of 2006 due to changes and refinements to assumptions used in the MSR valuation model. Other changes in fair value of the MSR asset, representing runoff of the asset against the realization of servicing cash flows, were negative \$1.4 billion. Noninterest expense was \$1.3 billion, up \$102 million, or 8%, due primarily to higher compensation expense related to an increase in loan officers.

#### **Mortgage Banking origination channels comprise the following:**

**Retail** – Borrowers who are buying or refinancing a home through direct contact with a mortgage banker employed by the Firm using a branch office, the Internet or by phone. Borrowers are frequently referred to a mortgage banker by real estate brokers, home builders or other third parties.

**Wholesale** – A third-party mortgage broker refers loan applications to a mortgage banker at the Firm. Brokers are independent loan originators that specialize in finding and counseling borrowers but do not provide funding for loans.

**Correspondent** – Banks, thrifts, other mortgage banks and other financial institutions that sell closed loans to the Firm.

**Correspondent negotiated transactions (“CNT”)** – Mid-to large-sized mortgage lenders, banks and bank-owned companies that sell loans or servicing to the Firm on an as-originated basis, excluding bulk servicing transactions.

**Production revenue** – Includes net gains or losses on originations and sales of prime and subprime mortgage loans and other production-related fees.

#### **Net Mortgage servicing revenue components:**

**Servicing revenue** – Represents all gross income earned from servicing third-party mortgage loans, including stated service fees, excess service fees, late fees and other ancillary fees.

**Changes in MSR asset fair value due to inputs or assumptions in model** – Represents MSR asset fair value adjustments due to changes in market-based inputs, such as interest rates and volatility, as well as updates to valuation assumptions used in the valuation model.

**Changes in MSR asset fair value due to other changes** – Includes changes in the MSR value due to modeled servicing portfolio runoff (or time decay). Effective January 1, 2006, the Firm implemented SFAS 156, adopting fair value for the MSR asset. For the year ended December 31, 2005, this amount represents MSR asset amortization expense calculated in accordance with SFAS 140.

**Derivative valuation adjustments and other** – Changes in the fair value of derivative instruments used to offset the impact of changes in market-based inputs to the MSR valuation model.

**MSR risk management results** – Includes changes in MSR asset fair value due to inputs or assumptions and derivative valuation adjustments and other.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### Auto Finance

#### Selected income statement data

Year ended December 31,  
(in millions, except ratios and  
where otherwise noted)

	2007	2006	2005
Noninterest revenue	\$ 551	\$ 368	\$ 86
Net interest income	1,206	1,171	1,235
<b>Total net revenue</b>	<b>1,757</b>	<b>1,539</b>	<b>1,321</b>
Provision for credit losses	380	207	212
Noninterest expense	890	761	671
<b>Income before income tax expense</b>	<b>487</b>	<b>571</b>	<b>438</b>
<b>Net income</b>	<b>\$ 295</b>	<b>\$ 346</b>	<b>\$ 268</b>
ROE	13%	14%	10%
ROA	0.68	0.77	0.50
<b>Business metrics (in billions)</b>			
Auto originations volume	\$ 21.3	\$ 19.3	\$ 18.1
End-of-period loans and lease-related assets			
Loans outstanding	\$ 42.0	\$ 39.3	\$ 41.7
Lease financing receivables	0.3	1.7	4.3
Operating lease assets	1.9	1.6	0.9
<b>Total end-of-period loans and lease-related assets</b>	<b>44.2</b>	<b>42.6</b>	<b>46.9</b>
Average loans and lease-related assets			
Loans outstanding <sup>(a)</sup>	\$ 40.2	\$ 39.8	\$ 45.5
Lease financing receivables	0.9	2.9	6.2
Operating lease assets	1.7	1.3	0.4
<b>Total average loans and lease-related assets</b>	<b>42.8</b>	<b>44.0</b>	<b>52.1</b>
Average assets	43.3	44.9	53.2
Average equity	2.2	2.4	2.7
<b>Credit quality statistics</b>			
30+ day delinquency rate	1.85%	1.72%	1.66%
Net charge-offs			
Loans	\$ 350	\$ 231	\$ 257
Lease receivables	4	7	20
<b>Total net charge-offs</b>	<b>354</b>	<b>238</b>	<b>277</b>
Net charge-off rate			
Loans <sup>(a)</sup>	0.87%	0.59%	0.57%
Lease receivables	0.44	0.24	0.32
<b>Total net charge-off rate<sup>(a)</sup></b>	<b>0.86</b>	<b>0.56</b>	<b>0.54</b>
Nonperforming assets	\$ 188	\$ 177	\$ 236

(a) Average Loans held-for-sale were \$530 million and \$744 million for 2006 and 2005, respectively. Average Loans held-for-sale for 2007 were insignificant. These amounts are excluded when calculating the net charge-off rate.

#### 2007 compared with 2006

Auto Finance Net income was \$295 million, a decrease of \$51 million, or 15%, from the prior year. Net revenue was \$1.8 billion, up \$218 million, or 14%, reflecting wider loan spreads and higher automobile operating lease revenue. The Provision for credit losses was \$380 million, up \$173 million, reflecting an increase in estimated losses. The net charge-off rate was 0.86% compared with 0.56% in the prior year. Noninterest expense of \$890 million increased \$129 million, or 17%, driven by increased depreciation expense on owned automobiles subject to operating leases.

#### 2006 compared with 2005

Net income of \$346 million was up \$78 million from the prior year, including the impact of a \$50 million 2006 loss and a \$136 million prior-year loss related to loans transferred to held-for-sale. Total net revenue of \$1.5 billion was up \$218 million, or 17%, reflecting higher automobile operating lease revenue and wider loan spreads on lower loan and direct finance lease balances. The Provision for credit losses of \$207 million decreased \$5 million from the prior year. Noninterest expense of \$761 million increased \$90 million, or 13%, driven by increased depreciation expense on owned automobiles subject to operating leases, partially offset by operating efficiencies.

## CARD SERVICES

**With 155 million cards in circulation and more than \$157 billion in managed loans, Card Services is one of the nation's largest credit card issuers. Customers used Chase cards to meet more than \$354 billion worth of their spending needs in 2007.**

**With hundreds of partnerships, Chase has a market leadership position in building loyalty programs with many of the world's most respected brands. The Chase-branded product line was strengthened in 2007 with enhancements to the popular Chase Freedom Program, which has generated more than one million new customers since its launch in 2006.**

**Chase Paymentech Solutions, LLC, a joint venture between JPMorgan Chase and First Data Corporation, is a processor of MasterCard and Visa payments, which handled more than 19 billion transactions in 2007.**

JPMorgan Chase uses the concept of "managed basis" to evaluate the credit performance of its credit card loans, both loans on the balance sheet and loans that have been securitized. For further information, see Explanation and reconciliation of the Firm's use of non-GAAP financial measures on pages 36–37 of this Annual Report. Managed results exclude the impact of credit card securitizations on Total net revenue, the Provision for credit losses, net charge-offs and loan receivables. Securitization does not change reported Net income; however, it does affect the classification of items on the Consolidated statements of income and Consolidated balance sheets.

### Selected income statement data – managed basis

Year ended December 31, (in millions, except ratios)	2007	2006	2005
<b>Revenue</b>			
Credit card income	\$ 2,685	\$ 2,587	\$ 3,351
All other income	361	357	212
<b>Noninterest revenue</b>	<b>3,046</b>	<b>2,944</b>	<b>3,563</b>
<b>Net interest income</b>	<b>12,189</b>	<b>11,801</b>	<b>11,803</b>
<b>Total net revenue</b>	<b>15,235</b>	<b>14,745</b>	<b>15,366</b>
Provision for credit losses	5,711	4,598	7,346
<b>Noninterest expense</b>			
Compensation expense	1,021	1,003	1,081
Noncompensation expense	3,173	3,344	3,170
Amortization of intangibles	720	739	748
<b>Total noninterest expense</b>	<b>4,914</b>	<b>5,086</b>	<b>4,999</b>
<b>Income before income tax expense</b>	<b>4,610</b>	<b>5,061</b>	<b>3,021</b>
Income tax expense	1,691	1,855	1,114
<b>Net income</b>	<b>\$ 2,919</b>	<b>\$ 3,206</b>	<b>\$ 1,907</b>
Memo: Net securitization gains	\$ 67	\$ 82	\$ 56
<b>Financial ratios</b>			
ROE	21%	23%	16%
Overhead ratio	32	34	33

*As a result of the integration of Chase Merchant Services and Paymentech merchant processing businesses into a joint venture, beginning in the fourth quarter of 2005, Total net revenue, Total non-interest expense and Income before income tax expense were reduced to reflect the deconsolidation of Paymentech. There was no impact to Net income. To illustrate underlying business trends, the following discussion of CS' performance assumes that the deconsolidation of Paymentech had occurred as of the beginning of 2005. For a further discussion of the deconsolidation of Paymentech, see Note 2 on pages 109–110, and Note 31 on pages 170–173, respectively, of this Annual Report. The following table presents a reconciliation of CS' managed basis to an adjusted basis to disclose the effect of the deconsolidation of Paymentech on CS' results for the periods presented.*

### Reconciliation of Card Services' managed results to an adjusted basis to disclose the effect of the Paymentech deconsolidation.

Year ended December 31, (in millions)	2007	2006	2005
<b>Noninterest revenue</b>			
Managed	\$ 3,046	\$ 2,944	\$ 3,563
Adjustment for Paymentech	—	—	(422)
<b>Adjusted Noninterest revenue</b>	<b>\$ 3,046</b>	<b>\$ 2,944</b>	<b>\$ 3,141</b>
<b>Total net revenue</b>			
Managed	\$ 15,235	\$ 14,745	\$ 15,366
Adjustment for Paymentech	—	—	(435)
<b>Adjusted Total net revenue</b>	<b>\$ 15,235</b>	<b>\$ 14,745</b>	<b>\$ 14,931</b>
<b>Total noninterest expense</b>			
Managed	\$ 4,914	\$ 5,086	\$ 4,999
Adjustment for Paymentech	—	—	(389)
<b>Adjusted Total noninterest expense</b>	<b>\$ 4,914</b>	<b>\$ 5,086</b>	<b>\$ 4,610</b>

### 2007 compared with 2006

Net income of \$2.9 billion was down \$287 million, or 9%, from the prior year. Prior-year results benefited from significantly lower net charge-offs following the change in bankruptcy legislation in the fourth quarter of 2005. The increase in net charge-offs was offset partially by higher revenue.

End-of-period managed loans of \$157.1 billion increased \$4.2 billion, or 3%, from the prior year. Average managed loans of \$149.3 billion increased \$8.2 billion, or 6%, from the prior year. The increases in both end-of-period and average managed loans resulted from organic growth.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

Managed Total net revenue was \$15.2 billion, an increase of \$490 million, or 3%, from the prior year. Net interest income was \$12.2 billion, up \$388 million, or 3%, from the prior year. The increase in Net interest income was driven by a higher level of fees and higher average loan balances. These benefits were offset partially by narrower loan spreads, the discontinuation of certain billing practices (including the elimination of certain over-limit fees and the two-cycle billing method for calculating finance charges beginning in the second quarter of 2007) and the effect of higher revenue reversals associated with higher charge-offs. Noninterest revenue was \$3.0 billion, an increase of \$102 million, or 3%, from the prior year. The increase reflects a higher level of fee-based revenue and increased net interchange income, which benefited from higher charge volume. Charge volume growth of 4% reflected a 9% increase in sales volume, offset primarily by a lower level of balance transfers, the result of more targeted marketing efforts.

The managed Provision for credit losses was \$5.7 billion, an increase of \$1.1 billion, or 24%, from the prior year. The increase was primarily due to a higher level of net charge-offs (the prior year benefited from the change in bankruptcy legislation in the fourth quarter of 2005) and an increase in the Allowance for loan losses driven by higher estimated net charge-offs in the portfolio. The managed net charge-off rate was 3.68%, up from 3.33% in the prior year. The 30-day managed delinquency rate was 3.48%, up from 3.13% in the prior year.

Noninterest expense was \$4.9 billion, a decrease of \$172 million, or 3%, compared with the prior year, primarily due to lower marketing expense and lower fraud-related expense, partially offset by higher volume-related expense.

### 2006 compared with 2005

Net income of \$3.2 billion was up \$1.3 billion, or 68%, from the prior year. Results were driven by a lower Provision for credit losses due to significantly lower bankruptcy filings.

End-of-period managed loans of \$152.8 billion increased \$10.6 billion, or 7%, from the prior year. Average managed loans of \$141.1 billion increased \$4.7 billion, or 3%, from the prior year. Compared with the prior year, both average managed and end-of-period managed loans continued to be affected negatively by higher customer payment rates. Management believes that contributing to the higher payment rates are the new minimum payment rules and a higher proportion of customers in rewards-based programs.

2006 benefited from organic growth and reflected acquisitions of two loan portfolios. The first portfolio was the Sears Canada credit card business, which closed in the fourth quarter of 2005. The Sears Canada portfolio's average managed loan balances were \$2.1 billion in 2006 and \$291 million in the prior year. The second purchase was the Kohl's Corporation ("Kohl's") private label portfolio, which closed in the second quarter of 2006. The Kohl's portfolio average and period-end managed loan balances for 2006 were \$1.2 billion and \$2.5 billion, respectively.

Managed Total net revenue of \$14.7 billion was down \$186 million, or 1%, from the prior year. Net interest income of \$11.8 billion was flat to the prior year. Net interest income benefited from an increase in average managed loan balances and lower revenue reversals associated with lower charge-offs. These increases were offset by attrition of mature, higher spread balances as a result of higher payment rates and higher cost of funds on balance growth in promotional, introductory and transactor loan balances, which increased due to continued investment in marketing. Noninterest revenue of \$2.9 billion was down \$197 million, or 6%. Interchange income increased, benefiting from 12% higher charge volume, but was more than offset by higher volume-driven payments to partners, including Kohl's, and increased rewards expense (both of which are netted against interchange income).

The managed Provision for credit losses was \$4.6 billion, down \$2.7 billion, or 37%, from the prior year. This benefit was due to a significant decrease in net charge-offs of \$2.4 billion, reflecting the continued low level of bankruptcy losses, partially offset by an increase in contractual net charge-offs. The provision also benefited from a release in the Allowance for loan losses in 2006 of unused reserves related to Hurricane Katrina, compared with an increase in the Allowance for loan losses in the prior year. The managed net charge-off rate decreased to 3.33%, from 5.21% in the prior year. The 30-day managed delinquency rate was 3.13%, up from 2.79% in the prior year.

Noninterest expense of \$5.1 billion was up \$476 million, or 10%, from the prior year due largely to higher marketing spending and acquisitions offset partially by merger savings.

### The following is a brief description of selected business metrics within Card Services.

- **Charge volume** – Represents the dollar amount of cardmember purchases, balance transfers and cash advance activity.
- **Net accounts opened** – Includes originations, purchases and sales.
- **Merchant acquiring business** – Represents an entity that processes bank card transactions for merchants. JPMorgan Chase is a partner in Chase Paymentech Solutions, LLC, a merchant acquiring business.
  - **Bank card volume** – Represents the dollar amount of transactions processed for merchants.
  - **Total transactions** – Represents the number of transactions and authorizations processed for merchants.

## Selected metrics

Year ended December 31,  
(in millions, except headcount, ratios  
and where otherwise noted)

	2007	2006	2005
<b>Financial metrics</b>			
% of average managed outstandings:			
Net interest income	8.16%	8.36%	8.65%
Provision for credit losses	3.82	3.26	5.39
Noninterest revenue	2.04	2.09	2.61
Risk adjusted margin <sup>(a)</sup>	6.38	7.19	5.88
Noninterest expense	3.29	3.60	3.67
Pretax income (ROO) <sup>(b)</sup>	3.09	3.59	2.21
Net income	1.95	2.27	1.40
<b>Business metrics</b>			
Charge volume (in billions)	\$ 354.6	\$ 339.6	\$ 301.9
Net accounts opened (in millions) <sup>(c)</sup>	16.4#	45.9#	21.1#
Credit cards issued (in millions)	155.0	154.4	110.4
Number of registered			
Internet customers (in millions)	28.3	22.5	14.6
Merchant acquiring business <sup>(d)</sup>			
Bank card volume (in billions)	\$ 719.1	\$ 660.6	\$ 563.1
Total transactions (in billions)	19.7#	18.2#	15.5#
<b>Selected ending balances</b>			
Loans:			
Loans on balance sheets	\$ 84,352	\$ 85,881	\$ 71,738
Securitized loans	72,701	66,950	70,527
<b>Managed loans</b>	<b>\$157,053</b>	<b>\$152,831</b>	<b>\$142,265</b>
<b>Selected average balances</b>			
Managed assets	\$155,957	\$148,153	\$141,933
Loans:			
Loans on balance sheets	\$ 79,980	\$ 73,740	\$ 67,334
Securitized loans	69,338	67,367	69,055
<b>Managed average loans</b>	<b>\$149,318</b>	<b>\$141,107</b>	<b>\$136,389</b>
Equity	\$ 14,100	\$ 14,100	\$ 11,800
<b>Headcount</b>	<b>18,554#</b>	<b>18,639#</b>	<b>18,629#</b>
<b>Managed credit quality statistics</b>			
Net charge-offs	\$ 5,496	\$ 4,698	\$ 7,100
Net charge-off rate	3.68%	3.33%	5.21%
<b>Managed delinquency ratios</b>			
30+ days	3.48%	3.13%	2.79%
90+ days	1.65	1.50	1.27
Allowance for loan losses <sup>(e)</sup>	\$ 3,407	\$ 3,176	\$ 3,274
Allowance for loan losses to period-end loans <sup>(e)</sup>	4.04%	3.70%	4.56%

(a) Represents Total net revenue less Provision for credit losses.

(b) Pretax return on average managed outstandings.

(c) 2006 included approximately 30 million accounts from loan portfolio acquisitions and 2005 included approximately 10 million accounts from portfolio acquisitions.

(d) Represents 100% of the merchant acquiring business.

(e) Loans on a reported basis.

The financial information presented below reconciles reported basis and managed basis to disclose the effect of securitizations.

Year ended December 31, (in millions)	2007	2006	2005
<b>Income statement data<sup>(a)</sup></b>			
Credit card income			
Reported	\$ 5,940	\$ 6,096	\$ 6,069
Securitization adjustments	(3,255)	(3,509)	(2,718)
<b>Managed credit card income</b>	<b>\$ 2,685</b>	<b>\$ 2,587</b>	<b>\$ 3,351</b>
Net interest income			
Reported	\$ 6,554	\$ 6,082	\$ 5,309
Securitization adjustments	5,635	5,719	6,494
<b>Managed net interest income</b>	<b>\$ 12,189</b>	<b>\$ 11,801</b>	<b>\$ 11,803</b>
Total net revenue			
Reported	\$ 12,855	\$ 12,535	\$ 11,590
Securitization adjustments	2,380	2,210	3,776
<b>Managed total net revenue</b>	<b>\$ 15,235</b>	<b>\$ 14,745</b>	<b>\$ 15,366</b>
Provision for credit losses			
Reported	\$ 3,331	\$ 2,388	\$ 3,570
Securitization adjustments	2,380	2,210	3,776
<b>Managed provision for credit losses</b>	<b>\$ 5,711</b>	<b>\$ 4,598</b>	<b>\$ 7,346</b>
<b>Balance sheet – average balances<sup>(a)</sup></b>			
Total average assets			
Reported	\$ 89,177	\$ 82,887	\$ 74,753
Securitization adjustments	66,780	65,266	67,180
<b>Managed average assets</b>	<b>\$155,957</b>	<b>\$148,153</b>	<b>\$141,933</b>
<b>Credit quality statistics<sup>(a)</sup></b>			
Net charge-offs			
Reported	\$ 3,116	\$ 2,488	\$ 3,324
Securitization adjustments	2,380	2,210	3,776
<b>Managed net charge-offs</b>	<b>\$ 5,496</b>	<b>\$ 4,698</b>	<b>\$ 7,100</b>

(a) For a discussion of managed basis, see the non-GAAP financial measures discussion on pages 36–37 of this Annual Report.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### COMMERCIAL BANKING

**Commercial Banking serves more than 30,000 clients nationally, including corporations, municipalities, financial institutions and not-for-profit entities with annual revenue generally ranging from \$10 million to \$2 billion. Commercial Banking delivers extensive industry knowledge, local expertise and a dedicated service model. In partnership with the Firm's other businesses, it provides comprehensive solutions including lending, treasury services, investment banking and asset management to meet its clients' domestic and international financial needs.**

#### Selected income statement data

Year ended December 31,  
(in millions, except ratios)

	2007	2006	2005
<b>Revenue</b>			
Lending & deposit-related fees	\$ 647	\$ 589	\$ 572
Asset management, administration and commissions	92	67	57
All other income <sup>(a)</sup>	524	417	357
<b>Noninterest revenue</b>	<b>1,263</b>	<b>1,073</b>	<b>986</b>
<b>Net interest income</b>	<b>2,840</b>	<b>2,727</b>	<b>2,502</b>
<b>Total net revenue</b>	<b>4,103</b>	<b>3,800</b>	<b>3,488</b>
Provision for credit losses <sup>(b)</sup>	279	160	73
<b>Noninterest expense</b>			
Compensation expense	706	740	654
Noncompensation expense	1,197	1,179	1,137
Amortization of intangibles	55	60	65
<b>Total noninterest expense</b>	<b>1,958</b>	<b>1,979</b>	<b>1,856</b>
<b>Income before income tax expense</b>	<b>1,866</b>	<b>1,661</b>	<b>1,559</b>
Income tax expense	732	651	608
<b>Net income</b>	<b>\$1,134</b>	<b>\$1,010</b>	<b>\$ 951</b>
<b>Financial ratios</b>			
ROE	17%	18%	28%
Overhead ratio	48	52	53

(a) Investment banking-related and commercial card revenue is included in all other income.

(b) 2005 includes a \$35 million special provision related to Hurricane Katrina.

On October 1, 2006, JPMorgan Chase completed the acquisition of The Bank of New York's consumer, business banking and middle-market banking businesses, adding approximately \$2.3 billion in loans and \$1.2 billion in deposits to the Commercial Bank.

#### 2007 compared with 2006

Net income was \$1.1 billion, an increase of \$124 million, or 12%, from the prior year due primarily to growth in total net revenue, partially offset by higher Provision for credit losses.

Record total net revenue of \$4.1 billion increased \$303 million, or 8%. Net interest income of \$2.8 billion increased \$113 million, or 4%, driven by double-digit growth in liability balances and loans, which reflected organic growth and the Bank of New York transaction, largely offset by the continued shift to narrower-spread liability products and spread compression in the loan and liability portfolios.

Noninterest revenue was \$1.3 billion, up \$190 million, or 18%, due to increased deposit-related fees, higher investment banking revenue, and gains on sales of securities acquired in the satisfaction of debt.

On a segment basis, Middle Market Banking revenue was \$2.7 billion, an increase of \$154 million, or 6%, primarily due to the Bank of New York transaction, higher deposit-related fees and growth in investment banking revenue. Mid-Corporate Banking revenue was \$815 million, an increase of \$159 million, or 24%, reflecting higher lending revenue, investment banking revenue, and gains on sales of securities acquired in the satisfaction of debt. Real Estate Banking revenue of \$421 million decreased \$37 million, or 8%.

Provision for credit losses was \$279 million, compared with \$160 million in the prior year. The increase in the allowance for credit losses reflected portfolio activity including slightly lower credit quality as well as growth in loan balances. The Allowance for loan losses to average loans retained was 2.81%, compared with 2.86% in the prior year.

Noninterest expense was \$2.0 billion, a decrease of \$21 million, or 1%, largely due to lower Compensation expense driven by the absence of prior-year expense from the adoption of SFAS 123R, partially offset by expense growth related to the Bank of New York transaction.

#### 2006 compared with 2005

Net income of \$1.0 billion increased \$59 million, or 6%, from the prior year due to higher revenue, partially offset by higher expense and Provision for credit losses.

Record total net revenue of \$3.8 billion increased 9%, or \$312 million. Net interest income increased to \$2.7 billion, primarily driven by higher liability balances and loan volumes, partially offset by loan spread compression and a shift to narrower-spread liability products. Noninterest revenue was \$1.1 billion, up \$87 million, or 9%, due to record Investment banking revenue and higher commercial card revenue.

Revenue grew for each CB business compared with the prior year, driven by increased treasury services, investment banking and lending revenue. Compared with the prior year, Middle Market Banking revenue of \$2.5 billion increased \$177 million, or 8%. Mid-Corporate Banking revenue of \$656 million increased \$105 million, or 19%, and Real Estate Banking revenue of \$458 million increased \$24 million, or 6%.

Provision for credit losses was \$160 million, up from \$73 million in the prior year, reflecting portfolio activity and the establishment of additional Allowance for loan losses related to loans acquired from The Bank of New York, partially offset by a release of the unused portion of the special reserve established in 2005 for Hurricane Katrina. Net charge-offs were flat compared with the prior year. Nonperforming loans declined 56%, to \$121 million.

Total noninterest expense of \$2.0 billion increased \$123 million, or 7%, from last year, primarily related to incremental compensation expense related to SFAS 123R and increased expense resulting from higher client usage of Treasury Services' products.

## Selected metrics

Year ended December 31,  
(in millions, except headcount  
and ratios)

	2007	2006	2005
<b>Revenue by product:</b>			
Lending	\$ 1,419	\$ 1,344	\$ 1,215
Treasury services	2,350	2,243	2,062
Investment banking	292	253	206
Other	42	(40)	5
<b>Total Commercial Banking revenue</b>	<b>\$ 4,103</b>	<b>\$ 3,800</b>	<b>\$ 3,488</b>
<b>IB revenue, gross<sup>(a)</sup></b>	<b>\$ 888</b>	<b>\$ 716</b>	<b>\$ 552</b>
<b>Revenue by business:</b>			
Middle Market Banking	\$ 2,689	\$ 2,535	\$ 2,358
Mid-Corporate Banking	815	656	551
Real Estate Banking	421	458	434
Other	178	151	145
<b>Total Commercial Banking revenue</b>	<b>\$ 4,103</b>	<b>\$ 3,800</b>	<b>\$ 3,488</b>
<b>Selected average balances:</b>			
Total assets	\$ 87,140	\$ 57,754	\$ 52,358
Loans:			
Loans retained	60,231	53,154	47,834
Loans held-for-sale and loans at fair value	863	442	283
Total loans <sup>(b)</sup>	61,094	53,596	48,117
Liability balances <sup>(c)</sup>	87,726	73,613	66,055
Equity	6,502	5,702	3,400
<b>Average loans by business:</b>			
Middle Market Banking	\$ 37,333	\$ 33,225	\$ 31,193
Mid-Corporate Banking	12,481	8,632	6,388
Real Estate Banking	7,116	7,566	6,909
Other	4,164	4,173	3,627
<b>Total Commercial Banking loans</b>	<b>\$ 61,094</b>	<b>\$ 53,596</b>	<b>\$ 48,117</b>
<b>Headcount</b>	<b>4,125#</b>	<b>4,459#</b>	<b>4,418#</b>
<b>Credit data and quality statistics:</b>			
Net charge-offs	\$ 44	\$ 27	\$ 26
Nonperforming loans	146	121	272
Allowance for credit losses:			
Allowance for loan losses	1,695	1,519	1,392
Allowance for lending-related commitments	236	187	154
Total allowance for credit losses	1,931	1,706	1,546
Net charge-off rate <sup>(b)</sup>	0.07%	0.05%	0.05%
Allowance for loan losses to average loans <sup>(b)</sup>	2.81	2.86	2.91
Allowance for loan losses to nonperforming loans	1,161	1,255	512
Nonperforming loans to average loans	0.24	0.23	0.57

(a) Represents the total revenue related to investment banking products sold to CB clients.

(b) Loans held-for-sale and loans accounted for at fair value under SFAS 159 were excluded when calculating the allowance coverage ratio and the net charge-off rate.

(c) Liability balances include deposits and deposits swept to on-balance sheet liabilities such as Commercial paper, Federal funds purchased and repurchase agreements.

## Commercial Banking revenue comprises the following:

**Lending** includes a variety of financing alternatives, which are primarily provided on a basis secured by receivables, inventory, equipment, real estate or other assets. Products include:

- Term loans
- Revolving lines of credit
- Bridge financing
- Asset-based structures
- Leases

**Treasury services** includes a broad range of products and services enabling clients to transfer, invest and manage the receipt and disbursement of funds, while providing the related information reporting. These products and services include:

- U.S. dollar and multi-currency clearing
- ACH
- Lockbox
- Disbursement and reconciliation services
- Check deposits
- Other check and currency-related services
- Trade finance and logistics solutions
- Commercial card
- Deposit products, sweeps and money market mutual funds

**Investment banking** provides clients with sophisticated capital-raising alternatives, as well as balance sheet and risk management tools, through:

- Advisory
- Equity underwriting
- Loan syndications
- Investment-grade debt
- Asset-backed securities
- Private placements
- High-yield bonds
- Derivatives
- Foreign exchange hedges
- Securities sales

## TREASURY &amp; SECURITIES SERVICES

**TSS is a global leader in transaction, investment and information services. TSS is one of the world's largest cash management providers and a leading global custodian. TS provides cash management, trade, wholesale card and liquidity products and services to small and mid-sized companies, multinational corporations, financial institutions and government entities. TS partners with the Commercial Banking, Retail Financial Services and Asset Management businesses to serve clients firmwide. As a result, certain TS revenue is included in other segments' results. WSS holds, values, clears and services securities, cash and alternative investments for investors and broker-dealers, and manages depositary receipt programs globally.**

As a result of the transaction with The Bank of New York on October 1, 2006, selected corporate trust businesses were transferred from TSS to the Corporate segment and are reported in discontinued operations for all periods presented.

**Selected income statement data**

Year ended December 31,  
(in millions, except ratios)

	2007	2006	2005
<b>Revenue</b>			
Lending & deposit-related fees	\$ 923	\$ 735	\$ 731
Asset management, administration and commissions	3,050	2,692	2,409
All other income	708	612	519
<b>Noninterest revenue</b>	<b>4,681</b>	<b>4,039</b>	<b>3,659</b>
<b>Net interest income</b>	<b>2,264</b>	<b>2,070</b>	<b>1,880</b>
<b>Total net revenue</b>	<b>6,945</b>	<b>6,109</b>	<b>5,539</b>
Provision for credit losses	19	(1)	—
Credit reimbursement to IB <sup>(a)</sup>	(121)	(121)	(154)
<b>Noninterest expense</b>			
Compensation expense	2,353	2,198	1,874
Noncompensation expense	2,161	1,995	2,095
Amortization of intangibles	66	73	81
<b>Total noninterest expense</b>	<b>4,580</b>	<b>4,266</b>	<b>4,050</b>
<b>Income before income tax expense</b>	<b>2,225</b>	<b>1,723</b>	<b>1,335</b>
Income tax expense	828	633	472
<b>Net income</b>	<b>\$1,397</b>	<b>\$1,090</b>	<b>\$ 863</b>
<b>Financial ratios</b>			
ROE	47%	48%	57%
Overhead ratio	66	70	73
Pretax margin ratio <sup>(b)</sup>	32	28	24

(a) TSS was charged a credit reimbursement related to certain exposures managed within the IB credit portfolio on behalf of clients shared with TSS.

(b) Pretax margin represents Income before income tax expense divided by Total net revenue, which is a measure of pretax performance and another basis by which management evaluates its performance and that of its competitors.

**2007 compared with 2006**

Net income was a record \$1.4 billion, an increase of \$307 million, or 28%, from the prior year, driven by record net revenue, partially offset by higher noninterest expense.

Total net revenue was \$6.9 billion, an increase of \$836 million, or 14%, from the prior year. Worldwide Securities Services net revenue of \$3.9 billion was up \$615 million, or 19%. The growth was driven by increased product usage by new and existing clients (primarily custody, securities lending, depositary receipts and fund services), market appreciation on assets under custody, and wider spreads on securities lending. These gains were offset partially by spread compression on liability products. Treasury Services net revenue was \$3.0 billion, an increase of \$221 million, or 8%, from the prior year. The results were driven by growth in electronic transaction volumes and higher liability balances, offset partially by a shift to narrower-spread liability products. TSS firmwide net revenue, which includes Treasury Services net revenue recorded in other lines of business, grew to \$9.6 billion, up \$1.0 billion, or 12%. Treasury Services firmwide net revenue grew to \$5.6 billion, up \$391 million, or 7%.

Noninterest expense was \$4.6 billion, an increase of \$314 million, or 7%, from the prior year, reflecting higher expense related to business and volume growth, as well as investment in new product platforms.

**2006 compared with 2005**

Net income was \$1.1 billion, an increase of \$227 million, or 26%, from the prior year. Earnings benefited from increased net revenue and the absence of prior-year charges of \$58 million (after-tax) related to the termination of a client contract, partially offset by higher compensation expense.

Total net revenue was \$6.1 billion, an increase of \$570 million, or 10%. Worldwide Securities Services net revenue of \$3.3 billion grew by \$473 million, or 17%. The growth was driven by increased product usage by new and existing clients (primarily custody, fund services, depositary receipts and securities lending) and market appreciation on assets under custody. Treasury Services net revenue of \$2.8 billion was up 4%. The growth was driven by higher liability balances, offset partially by a shift to narrower-spread liability products. TSS firmwide net revenue, which includes Treasury Services net revenue recorded in other lines of business, grew to \$8.6 billion, up \$778 million, or 10%. Treasury Services firmwide net revenue grew to \$5.2 billion, an increase of \$305 million, or 6%.

Total noninterest expense was \$4.3 billion, up \$216 million, or 5%. The increase was due to higher compensation expense related to increased client activity, business growth, investment in new product platforms and incremental expense related to SFAS 123R, partially offset by the absence of prior-year charges of \$93 million related to the termination of a client contract.

## Selected metrics

Year ended December 31,  
(in millions, except headcount, ratio data  
and where otherwise noted)

	2007	2006	2005
<b>Revenue by business</b>			
Treasury Services	\$ 3,013	\$ 2,792	\$ 2,695
Worldwide Securities Services	3,932	3,317	2,844
<b>Total net revenue</b>	<b>\$ 6,945</b>	<b>\$ 6,109</b>	<b>\$ 5,539</b>
<b>Business metrics</b>			
Assets under custody (in billions)	\$ 15,946	\$ 13,903	\$ 10,662
Number of:			
US\$ ACH transactions originated (in millions)	3,870#	3,503#	2,966#
Total US\$ clearing volume (in thousands)	111,036	104,846	95,713
International electronic funds transfer volume (in thousands) <sup>(a)</sup>	168,605	145,325	89,537
Wholesale check volume (in millions)	2,925	3,409	3,735
Wholesale cards issued (in thousands) <sup>(b)</sup>	18,722	17,228	13,206
<b>Selected balance sheets (average)</b>			
Total assets	\$ 53,350	\$ 31,760	\$ 28,206
Loans <sup>(c)</sup>	20,821	15,564	12,349
Liability balances <sup>(d)</sup>	228,925	189,540	154,731
Equity	3,000	2,285	1,525
<b>Headcount</b>	<b>25,669#</b>	<b>25,423#</b>	<b>22,207#</b>
<b>TSS firmwide metrics</b>			
Treasury Services firmwide revenue <sup>(e)</sup>	\$ 5,633	\$ 5,242	\$ 4,937
Treasury & Securities Services firmwide revenue <sup>(e)</sup>	9,565	8,559	7,781
Treasury Services firmwide overhead ratio <sup>(f)</sup>	56%	56%	58%
Treasury & Securities Services firmwide overhead ratio <sup>(f)</sup>	60	62	65
Treasury Services firmwide liability balances (average) <sup>(g)</sup>	\$199,077	\$162,020	\$139,579
Treasury & Securities Services firmwide liability balances <sup>(g)</sup>	316,651	262,678	220,781

(a) International electronic funds transfer includes non-US\$ ACH and clearing volume.

(b) Wholesale cards issued include domestic commercial card, stored value card, prepaid card and government electronic benefit card products.

(c) Loan balances include wholesale overdrafts, commercial cards and trade finance loans.

(d) Liability balances include deposits and deposits swept to on-balance sheet liabilities such as Commercial paper, Federal funds purchased and repurchase agreements.

(e) Firmwide revenue includes TS revenue recorded in the CB, Regional Banking and AM lines of business (see below) and excludes FX revenue recorded in the IB for TSS-related FX activity.

(in millions)	2007	2006	2005
Treasury Services revenue reported in CB	\$ 2,350	\$ 2,243	\$ 2,062
Treasury Services revenue reported in other lines of business	270	207	180

TSS firmwide FX revenue, which includes FX revenue recorded in TSS and FX revenue associated with TSS customers who are FX customers of the IB, was \$552 million, \$445 million and \$382 million for the years ended December 31, 2007, 2006 and 2005, respectively.

(f) Overhead ratios have been calculated based upon firmwide revenue and TSS and TS expense, respectively, including those allocated to certain other lines of business. FX revenue and expense recorded in the IB for TSS-related FX activity are not included in this ratio.

(g) Firmwide liability balances include TS' liability balances recorded in certain other lines of business.

**Treasury & Securities Services** firmwide metrics include certain TSS product revenue and liability balances reported in other lines of business for customers who are also customers of those lines of business. Management reviews firmwide metrics such as liability balances, revenue and overhead ratios in assessing financial performance for TSS as such firmwide metrics capture the firmwide impact of TS' and TSS' products and services. Management believes such firmwide metrics are necessary in order to understand the aggregate TSS business.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### ASSET MANAGEMENT

**With assets under supervision of \$1.6 trillion, AM is a global leader in investment and wealth management. AM clients include institutions, retail investors and high-net-worth individuals in every major market throughout the world. AM offers global investment management in equities, fixed income, real estate, hedge funds, private equity and liquidity, including both money-market instruments and bank deposits. AM also provides trust and estate and banking services to high-net-worth clients, and retirement services for corporations and individuals. The majority of AM's client assets are in actively managed portfolios.**

#### Selected income statement data

Year ended December 31,  
(in millions, except ratios)

	2007	2006	2005
<b>Revenue</b>			
Asset management, administration and commissions	\$6,821	\$5,295	\$4,189
All other income	654	521	394
<b>Noninterest revenue</b>	<b>7,475</b>	<b>5,816</b>	<b>4,583</b>
<b>Net interest income</b>	<b>1,160</b>	<b>971</b>	<b>1,081</b>
<b>Total net revenue</b>	<b>8,635</b>	<b>6,787</b>	<b>5,664</b>
Provision for credit losses	(18)	(28)	(56)
<b>Noninterest expense</b>			
Compensation expense	3,521	2,777	2,179
Noncompensation expense	1,915	1,713	1,582
Amortization of intangibles	79	88	99
<b>Total noninterest expense</b>	<b>5,515</b>	<b>4,578</b>	<b>3,860</b>
<b>Income before income tax expense</b>	<b>3,138</b>	<b>2,237</b>	<b>1,860</b>
Income tax expense	1,172	828	644
<b>Net income</b>	<b>\$1,966</b>	<b>\$1,409</b>	<b>\$1,216</b>
<b>Financial ratios</b>			
ROE	51%	40%	51%
Overhead ratio	64	67	68
Pretax margin ratio <sup>(a)</sup>	36	33	33

(a) Pretax margin represents Income before income tax expense divided by Total net revenue, which is a measure of pretax performance and another basis by which management evaluates its performance and that of its competitors.

#### 2007 compared with 2006

Net income was a record \$2.0 billion, an increase of \$557 million, or 40%, from the prior year. Results benefited from record net revenue, partially offset by higher noninterest expense.

Net revenue was \$8.6 billion, an increase of \$1.8 billion, or 27%, from the prior year. Noninterest revenue, primarily fees and commissions, was \$7.5 billion, up \$1.7 billion, or 29%, largely due to increased assets under management and higher performance and placement fees. Net interest income was \$1.2 billion, up \$189 million, or 19%, from the prior year, largely due to higher deposit and loan balances.

Institutional revenue grew 28%, to \$2.5 billion, due to net asset inflows and performance fees. Private Bank revenue grew 37%, to \$2.6 billion, due to higher assets under management, performance and placement fees, and increased loan and deposit balances. Retail revenue grew 28%, to \$2.4 billion, primarily due to market appreciation and net asset inflows. Private Client Services revenue grew 7%, to \$1.1 billion, reflecting higher assets under management and higher deposit balances.

The provision for credit losses was a benefit of \$18 million, compared with a benefit of \$28 million in the prior year.

Noninterest expense was \$5.5 billion, an increase of \$937 million, or 20%, from the prior year. The increase was due primarily to higher performance-based compensation expense and investments in all business segments.

#### 2006 compared with 2005

Net income was a record \$1.4 billion, up \$193 million, or 16%, from the prior year. Improved results were driven by increased revenue offset partially by higher performance-based compensation expense, incremental expense from the adoption of SFAS 123R and the absence of a tax credit recognized in the prior year.

Total net revenue was a record \$6.8 billion, up \$1.1 billion, or 20%, from the prior year. Noninterest revenue, principally fees and commissions, of \$5.8 billion was up \$1.2 billion, or 27%. This increase was due largely to increased assets under management and higher performance and placement fees. Net interest income was \$971 million, down \$110 million, or 10%, from the prior year. The decline was due primarily to narrower spreads on deposit products and the absence of BrownCo, partially offset by higher deposit and loan balances.

Institutional revenue grew 41%, to \$2.0 billion, due to net asset inflows and higher performance fees. Private Bank revenue grew 13%, to \$1.9 billion, due to increased placement activity, higher asset management fees and higher deposit balances, partially offset by narrower average spreads on deposits. Retail revenue grew 22%, to \$1.9 billion, primarily due to net asset inflows, partially offset by the sale of BrownCo. Private Client Services revenue decreased 1%, to \$1.0 billion, as higher deposit and loan balances were more than offset by narrower average deposit and loan spreads.

Provision for credit losses was a benefit of \$28 million compared with a benefit of \$56 million in the prior year. The 2006 benefit reflects a high level of recoveries and stable credit quality.

Total noninterest expense of \$4.6 billion was up \$718 million, or 19%, from the prior year. The increase was due to higher performance-based compensation, incremental expense related to SFAS 123R, increased salaries and benefits related to business growth, and higher minority interest expense related to Highbridge, partially offset by the absence of BrownCo.

## Selected metrics

Year ended December 31,  
(in millions, except headcount, ranking  
data, and where otherwise noted)

	2007	2006	2005
<b>Revenue by client segment</b>			
Institutional	\$ 2,525	\$ 1,972	\$ 1,395
Private Bank	2,605	1,907	1,689
Retail	2,408	1,885	1,544
Private Client Services	1,097	1,023	1,036
<b>Total net revenue</b>	<b>\$ 8,635</b>	<b>\$ 6,787</b>	<b>\$ 5,664</b>

## Business metrics

Number of:

Client advisors	1,729#	1,506#	1,484#
Retirement planning services participants	1,501,000	1,362,000	1,299,000

% of customer assets in 4 & 5 Star

Funds <sup>(a)</sup>	55%	58%	46%
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% of AUM in 1<sup>st</sup> and 2<sup>nd</sup> quartiles:<sup>(b)</sup>

1 year	57%	83%	69%
3 years	75%	77%	68%
5 years	76%	79%	74%

## Selected balance sheets data (average)

Total assets	\$ 51,882	\$ 43,635	\$ 41,599
Loans <sup>(c)(d)</sup>	29,496	26,507	26,610
Deposits <sup>(d)</sup>	58,863	50,607	42,123
Equity	3,876	3,500	2,400

<b>Headcount</b>	<b>14,799#</b>	<b>13,298#</b>	<b>12,127#</b>
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## Credit data and quality statistics

Net charge-offs (recoveries)	\$ (8)	\$ (19)	\$ 23
Nonperforming loans	12	39	104
Allowance for loan losses	112	121	132
Allowance for lending-related commitments	7	6	4
Net charge-off (recovery) rate	(0.03)%	(0.07)%	0.09%
Allowance for loan losses to average loans	0.38	0.46	0.50
Allowance for loan losses to nonperforming loans	933	310	127
Nonperforming loans to average loans	0.04	0.15	0.39

(a) Derived from following rating services: Morningstar for the United States; Micropal for the United Kingdom, Luxembourg, Hong Kong and Taiwan; and Nomura for Japan.

(b) Derived from following rating services: Lipper for the United States and Taiwan; Micropal for the United Kingdom, Luxembourg and Hong Kong; and Nomura for Japan.

(c) Held-for-investment prime mortgage loans transferred from AM to Treasury within the Corporate segment during 2007 were \$6.5 billion. There were no loans transferred during 2006 or 2005. Although the loans, together with the responsibility for the investment management of the portfolio, were transferred to Treasury, the transfer has no material impact on the financial results of AM.

(d) The sale of BrownCo, which closed on November 30, 2005, included \$3.0 billion in both loans and deposits.

## AM's client segments comprise the following:

**Institutional** brings comprehensive global investment services – including asset management, pension analytics, asset-liability management and active risk budgeting strategies – to corporate and public institutions, endowments, foundations, not-for-profit organizations and governments worldwide.

**Retail** provides worldwide investment management services and retirement planning and administration through third-party and direct distribution of a full range of investment vehicles.

The **Private Bank** addresses every facet of wealth management for ultra-high-net-worth individuals and families worldwide, including investment management, capital markets and risk management, tax and estate planning, banking, capital raising and specialty-wealth advisory services.

**Private Client Services** offers high-net-worth individuals, families and business owners in the United States comprehensive wealth management solutions, including investment management, capital markets and risk management, tax and estate planning, banking and specialty-wealth advisory services.

## JPMorgan Asset Management has established two high-level measures of its overall performance.

- Percentage of assets under management in funds rated 4 and 5 stars (3 year). Mutual fund rating services rank funds based on their risk-adjusted performance over various periods. A 5 star rating is the best and represents the top 10% of industry wide ranked funds. A 4 star rating represents the next 22% of industry wide ranked funds. The worst rating is a 1 star rating.
- Percentage of assets under management in first- or second-quartile funds (one, three and five years). Mutual fund rating services rank funds according to a peer-based performance system, which measures returns according to specific time and fund classification (small, mid, multi and large cap).

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### Assets under supervision

#### 2007 compared with 2006

Assets under supervision ("AUS") were \$1.6 trillion, an increase of \$225 billion, or 17%, from the prior year. Assets under management ("AUM") were \$1.2 trillion, up 18%, or \$180 billion, from the prior year. The increase in AUM was the result of net asset inflows into liquidity and alternative products and market appreciation across all segments. Custody, brokerage, administration and deposit balances were \$379 billion, up \$45 billion. The Firm also has a 44% interest in American Century Companies, Inc., whose AUM totaled \$102 billion and \$103 billion at December 31, 2007 and 2006, respectively, which are excluded from the AUM above.

#### 2006 compared with 2005

AUS were \$1.3 trillion, up 17%, or \$198 billion, from the prior year. AUM were \$1.0 trillion, up 20%, or \$166 billion, from the prior year. The increase in AUM was the result of net asset inflows in the Retail segment, primarily in equity-related products, Institutional segment flows, primarily in liquidity products and market appreciation. Custody, brokerage, administration and deposit balances were \$334 billion, up \$32 billion. The AUM of American Century Companies, Inc., totaled \$103 billion and \$101 billion at December 31, 2006 and 2005, respectively, which are excluded from the AUM above.

#### Assets under supervision<sup>(a)</sup>

As of or for the year ended December 31, (in billions)

	2007	2006	2005
<b>Assets by asset class</b>			
Liquidity <sup>(b)</sup>	\$ 400	\$ 311	\$ 238
Fixed income	200	175	165
Equities & balanced	472	427	370
Alternatives	121	100	74
<b>Total Assets under management</b>	<b>1,193</b>	<b>1,013</b>	<b>847</b>
Custody/brokerage/ administration/deposits	379	334	302
<b>Total Assets under supervision</b>	<b>\$ 1,572</b>	<b>\$ 1,347</b>	<b>\$ 1,149</b>

#### Assets by client segment

Institutional <sup>(c)</sup>	\$ 632	\$ 538	\$ 481
Private Bank	201	159	145
Retail <sup>(c)</sup>	300	259	169
Private Client Services	60	57	52
<b>Total Assets under management</b>	<b>\$ 1,193</b>	<b>\$ 1,013</b>	<b>\$ 847</b>
Institutional <sup>(c)</sup>	\$ 633	\$ 539	\$ 484
Private Bank	433	357	318
Retail <sup>(c)</sup>	394	343	245
Private Client Services	112	108	102
<b>Total Assets under supervision</b>	<b>\$ 1,572</b>	<b>\$ 1,347</b>	<b>\$ 1,149</b>

#### Assets by geographic region

U.S./Canada	\$ 760	\$ 630	\$ 562
International	433	383	285
<b>Total Assets under management</b>	<b>\$ 1,193</b>	<b>\$ 1,013</b>	<b>\$ 847</b>
U.S./Canada	\$ 1,032	\$ 889	\$ 805
International	540	458	344
<b>Total Assets under supervision</b>	<b>\$ 1,572</b>	<b>\$ 1,347</b>	<b>\$ 1,149</b>

#### Mutual fund assets by asset class

Liquidity	\$ 339	\$ 255	\$ 182
Fixed income	46	46	45
Equities	224	206	150
<b>Total mutual fund assets</b>	<b>\$ 609</b>	<b>\$ 507</b>	<b>\$ 377</b>

#### Assets under management rollforward

Beginning balance, January 1	\$ 1,013	\$ 847	\$ 791
Net asset flows:			
Liquidity	78	44	8
Fixed income	9	11	—
Equities, balanced and alternative	28	34	24
Market/performance/other impacts	65	77	24
<b>Ending balance, December 31</b>	<b>\$ 1,193</b>	<b>\$ 1,013</b>	<b>\$ 847</b>

#### Assets under supervision rollforward

Beginning balance, January 1	\$ 1,347	\$ 1,149	\$ 1,106
Net asset flows	143	102	49
Acquisitions/divestitures <sup>(d)</sup>	—	—	(33)
Market/performance/other impacts	82	96	27
<b>Ending balance, December 31</b>	<b>\$ 1,572</b>	<b>\$ 1,347</b>	<b>\$ 1,149</b>

(a) Excludes Assets under management of American Century Companies, Inc., in which the Firm had a 44% ownership at December 31, 2007.

(b) 2006 data reflects the reclassification of \$19 billion of assets under management into liquidity from other asset classes. Prior period data were not restated.

(c) In 2006, assets under management of \$22 billion from Retirement planning services has been reclassified from the Institutional client segment to the Retail client segment in order to be consistent with the revenue by client segment reporting.

(d) Reflects the sale of BrownCo (\$33 billion) in 2005.

## CORPORATE

The Corporate sector comprises Private Equity, Treasury, corporate staff units and expense that is centrally managed. Private Equity includes the JPMorgan Partners and ONE Equity Partners businesses.

Treasury manages capital, liquidity, interest rate and foreign exchange risk and the investment portfolio for the Firm. The corporate staff units include Central Technology and Operations, Internal Audit, Executive Office, Finance, Human Resources, Marketing & Communications, Legal & Compliance, Corporate Real Estate and General Services, Risk Management and Strategy & Development. Other centrally managed expense includes the Firm's occupancy and pension-related expense, net of allocations to the business.

### Selected income statement data

Year ended December 31,  
(in millions)

	2007	2006	2005
<b>Revenue</b>			
Principal transactions <sup>(a)(b)</sup>	\$ 4,552	\$ 1,181	\$ 1,527
Securities gains (losses)	39	(608)	(1,487)
All other income <sup>(c)</sup>	441	485	1,583
<b>Noninterest revenue</b>	<b>5,032</b>	<b>1,058</b>	<b>1,623</b>
<b>Net interest income (expense)</b>	<b>(787)</b>	<b>(1,044)</b>	<b>(2,756)</b>
<b>Total net revenue</b>	<b>4,245</b>	<b>14</b>	<b>(1,133)</b>
Provision for credit losses	(11)	(1)	10
<b>Noninterest expense</b>			
Compensation expense <sup>(b)</sup>	2,754	2,626	3,148
Noncompensation expense <sup>(d)</sup>	3,030	2,357	5,965
Merger costs	209	305	722
Subtotal	5,993	5,288	9,835
Net expense allocated to other businesses	(4,231)	(4,141)	(4,505)
<b>Total noninterest expense</b>	<b>1,762</b>	<b>1,147</b>	<b>5,330</b>
<b>Income (loss) from continuing operations before income tax expense</b>	<b>2,494</b>	<b>(1,132)</b>	<b>(6,473)</b>
Income tax expense (benefit) <sup>(e)</sup>	719	(1,179)	(2,690)
<b>Income (loss) from continuing operations</b>	<b>1,775</b>	<b>47</b>	<b>(3,783)</b>
<b>Income from discontinued operations<sup>(f)</sup></b>	<b>—</b>	<b>795</b>	<b>229</b>
<b>Net income (loss)</b>	<b>\$ 1,775</b>	<b>\$ 842</b>	<b>\$(3,554)</b>

(a) The Firm adopted SFAS 157 in the first quarter of 2007. See Note 4 on pages 111–118 of this Annual Report for additional information.

(b) 2007 included the classification of certain private equity carried interest from Principal transactions to Compensation expense.

(c) Included a gain of \$1.3 billion on the sale of BrownCo in 2005.

(d) Included insurance recoveries related to material legal proceedings of \$512 million and \$208 million in 2006 and 2005, respectively. Includes litigation reserve charges of \$2.8 billion in 2005.

(e) Includes tax benefits recognized upon resolution of tax audits.

(f) Included a \$622 million gain from the sale of selected corporate trust businesses in the fourth quarter of 2006.

### 2007 compared with 2006

Net income was \$1.8 billion, compared with \$842 million in the prior year, benefiting from strong Private Equity gains, partially offset by higher expense. Prior-year results also included Income from discontinued operations of \$795 million, which included a one-time gain of \$622 million from the sale of selected corporate trust businesses.

Net income for Private Equity was \$2.2 billion, compared with \$627 million in the prior year. Total net revenue was \$4.0 billion, an increase of \$2.8 billion. The increase was driven by Private Equity gains of \$4.1 billion, compared with \$1.3 billion, reflecting a higher level of gains and the change in classification of carried interest to compensation expense. Total noninterest expense was \$589 million, an increase of \$422 million from the prior year. The increase was driven by higher compensation expense reflecting the change in the classification of carried interest.

Net loss for Treasury and Other Corporate was \$390 million compared with a net loss of \$580 million in the prior year. Treasury and Other Corporate Total net revenue was \$278 million, an increase of \$1.4 billion. Revenue benefited from net security gains compared with net security losses in the prior year and improved net interest spread. Total noninterest expense was \$1.2 billion, an increase of \$193 million from the prior year. The increase reflected higher net litigation expense driven by credit card-related litigation and the absence of prior-year insurance recoveries related to certain material litigation partially offset by lower compensation expense.

### 2006 compared with 2005

On August 1, 2006, the buyout and growth equity professionals of JPMorgan Partners ("JPMP") formed an independent firm, CCMP Capital, LLC ("CCMP"), and the venture professionals separately formed an independent firm, Panorama Capital, LLC ("Panorama"). The investment professionals of CCMP and Panorama continue to manage the former JPMP investments pursuant to a management agreement with the Firm.

On October 1, 2006, the Firm completed the exchange of selected corporate trust businesses, including trustee, paying agent, loan agency and document management services, for the consumer, business banking and middle-market banking businesses of The Bank of New York. These corporate trust businesses, which were previously reported in TSS, are now reported as discontinued operations for all periods presented within Corporate. The related balance sheet and income statement activity were transferred to the Corporate segment commencing with the second quarter of 2006. Periods prior to the second quarter of 2006 were revised to reflect this transfer.

Net income was \$842 million compared with a net loss of \$3.6 billion in the prior year, benefiting from lower net litigation costs and improved Treasury investment performance. Prior-year results included a \$752 million gain on the sale of BrownCo.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

Net income for Private Equity was \$627 million, compared with \$821 million in the prior year. Net revenue was \$1.1 billion, a decrease of \$379 million. The decrease was driven by lower Private Equity gains. Noninterest expense was \$167 million, a decrease of \$78 million from the prior year.

Net loss for Treasury and Other Corporate was \$580 million compared with a net loss of \$4.6 billion. Treasury and Other Corporate net revenue was a negative \$1.1 billion compared with negative \$2.7 billion. The improvement reflected higher net interest income, which was driven by an improved net interest spread, an increase in AFS securities and lower security losses. Prior-year results included a gain of \$1.3 billion on the sale of BrownCo. Noninterest expense was \$980 million, a decrease of \$4.1 billion from the prior year. Insurance recoveries relating to certain material litigation were \$512 million in 2006, while the prior-year results included a material litigation charge of \$2.8 billion and related insurance recoveries of \$208 million. Merger costs were \$305 million, compared with \$722 million in the prior year.

Discontinued operations include the results of operations of selected corporate trust businesses that were sold to The Bank of New York on October 1, 2006. Prior to the sale, the selected corporate trust businesses produced \$173 million of Income from discontinued operations in 2006, compared with \$229 million in the prior year. Income from discontinued operations for 2006 also included a one-time gain of \$622 million related to the sale of these businesses.

### Selected metrics

Year ended December 31, (in millions, except headcount)	2007	2006	2005
<b>Total net revenue</b>			
Private equity <sup>(a)(b)</sup>	\$ 3,967	\$ 1,142	\$ 1,521
Treasury and Corporate other <sup>(c)</sup>	278	(1,128)	(2,654)
<b>Total net revenue</b>	<b>\$ 4,245</b>	<b>\$ 14</b>	<b>\$ (1,133)</b>
<b>Net income (loss)</b>			
Private equity <sup>(a)</sup>	\$ 2,165	\$ 627	\$ 821
Treasury and Corporate other <sup>(c)(d)(e)</sup>	(260)	(391)	(4,156)
Merger costs	(130)	(189)	(448)
<b>Income (loss) from continuing operations</b>	<b>1,775</b>	<b>47</b>	<b>(3,783)</b>
<b>Income from discontinued operations (after-tax)<sup>(f)</sup></b>	<b>—</b>	<b>795</b>	<b>229</b>
<b>Total net income (loss)</b>	<b>\$ 1,775</b>	<b>\$ 842</b>	<b>\$ (3,554)</b>
Headcount	22,512#	23,242#	30,666#

(a) The Firm adopted SFAS 157 in the first quarter of 2007. See Note 4 on pages 111–118 of this Annual Report for additional information.

(b) 2007 included the classification of certain private equity carried interest from Net revenue to Compensation expense.

(c) Included a gain of \$752 million (\$1.3 billion pretax) on the sale of BrownCo in 2005. (d) Included insurance recoveries (after-tax) related to material legal proceedings of \$317 million and \$129 million in 2006 and 2005, respectively. Includes litigation reserve charges (after-tax) of \$1.7 billion in 2005.

(e) Includes tax benefits recognized upon resolution of tax audits.

(f) Included a \$622 million gain from the sale of selected corporate trust business in the fourth quarter of 2006.

## Private equity portfolio

### 2007 compared with 2006

The carrying value of the private equity portfolio at December 31, 2007, was \$7.2 billion, up from \$6.1 billion from December 31, 2006. The portfolio increase was due primarily to favorable valuation adjustments on nonpublic investments and new investments, partially offset by sales activity. The portfolio represented 9.2% of the Firm's stockholders' equity less goodwill at December 31, 2007, up from 8.6% at December 31, 2006.

### 2006 compared with 2005

The carrying value of the private equity portfolio declined by \$95 million to \$6.1 billion as of December 31, 2006. This decline was due primarily to sales, partially offset by new investment activity. The portfolio represented 8.6% of the Firm's stockholder equity less goodwill at December 31, 2006, down from 9.7% at December 31, 2005.

### Selected income statement and balance sheet data

Year ended December 31, (in millions)	2007	2006	2005
<b>Treasury</b>			
Securities gains (losses) <sup>(a)</sup>	\$ 37	\$ (619)	\$ (1,486)
Investment portfolio (average)	85,517	63,361	46,520
Investment portfolio (ending)	76,200	82,091	30,741
Mortgage loans (average) <sup>(b)</sup>	29,118	—	—
Mortgage loans (ending) <sup>(b)</sup>	36,942	—	—
<b>Private equity</b>			
Realized gains	\$ 2,312	\$ 1,223	\$ 1,969
Unrealized gains (losses)	1,607	(1)	(410)
<b>Total direct investments<sup>(c)</sup></b>	<b>3,919</b>	<b>1,222</b>	<b>1,559</b>
Third-party fund investments	165	77	132
<b>Total private equity gains<sup>(d)</sup></b>	<b>\$ 4,084</b>	<b>\$ 1,299</b>	<b>\$ 1,691</b>

### Private equity portfolio information<sup>(e)</sup>

#### Direct investments

##### Publicly held securities

Carrying value	\$ 390	\$ 587	\$ 479
Cost	288	451	403
Quoted public value	536	831	683

##### Privately held direct securities

Carrying value	5,914	4,692	5,028
Cost	4,867	5,795	6,463

#### Third-party fund investments<sup>(f)</sup>

Carrying value	849	802	669
Cost	1,076	1,080	1,003

Total private equity portfolio – Carrying value	\$ 7,153	\$ 6,081	\$ 6,176
Total private equity portfolio – Cost	\$ 6,231	\$ 7,326	\$ 7,869

(a) Losses reflected repositioning of the Treasury investment securities portfolio. Excludes gains/losses on securities used to manage risks associated with MSRs.

(b) In 2007, held-for-investment prime mortgage loans were transferred from RFS and AM. The transfer has no material impact on the financial results of Corporate.

(c) Private equity gains include a fair value adjustment related to the adoption of SFAS 157 in the first quarter of 2007.

(d) Included in Principal transactions revenue.

(e) For more information on the Firm's policies regarding the valuation of the private equity portfolio, see Note 4 on pages 111–118 of this Annual Report.

(f) Unfunded commitments to third-party equity funds were \$881 million, \$589 million and \$242 million at December 31, 2007, 2006 and 2005, respectively.

## BALANCE SHEET ANALYSIS

### Condensed consolidated balance sheet data

December 31, (in millions)	2007	2006
<b>Assets</b>		
Cash and due from banks	\$ 40,144	\$ 40,412
Deposits with banks	11,466	13,547
Federal funds sold and securities purchased under resale agreements	170,897	140,524
Securities borrowed	84,184	73,688
Trading assets:		
Debt and equity instruments	414,273	310,137
Derivative receivables	77,136	55,601
Securities	85,450	91,975
Loans	519,374	483,127
Allowance for loan losses	(9,234)	(7,279)
<b>Loans, net of Allowance for loan losses</b>	<b>510,140</b>	<b>475,848</b>
Accrued interest and accounts receivable	24,823	22,891
Goodwill	45,270	45,186
Other intangible assets	14,731	14,852
Other assets	83,633	66,859
<b>Total assets</b>	<b>\$ 1,562,147</b>	<b>\$ 1,351,520</b>
<b>Liabilities</b>		
Deposits	\$ 740,728	\$ 638,788
Federal funds purchased and securities sold under repurchase agreements	154,398	162,173
Commercial paper and other borrowed funds	78,431	36,902
Trading liabilities:		
Debt and equity instruments	89,162	90,488
Derivative payables	68,705	57,469
Accounts payable, accrued expense and other liabilities	94,476	88,096
Beneficial interests issued by consolidated VIEs	14,016	16,184
Long-term debt and trust preferred capital debt securities	199,010	145,630
<b>Total liabilities</b>	<b>1,438,926</b>	<b>1,235,730</b>
<b>Stockholders' equity</b>	<b>123,221</b>	<b>115,790</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,562,147</b>	<b>\$ 1,351,520</b>

### Consolidated balance sheets overview

The following is a discussion of the significant changes in the Consolidated balance sheet items from December 31, 2006.

#### Deposits with banks; Federal funds sold and securities purchased under resale agreements; Securities borrowed; Federal funds purchased and securities sold under repurchase agreements

The Firm utilizes Deposits with banks, Federal funds sold and securities purchased under resale agreements, Securities borrowed, and Federal funds purchased and securities sold under repurchase agreements as part of its liquidity management activities to manage the Firm's cash positions and risk-based capital requirements, and to support the Firm's trading activities and its risk management activities. In particular, Federal funds purchased and securities sold under repurchase agreements are used as short-term funding sources. The increase from December 31, 2006, in Federal funds sold and securities purchased under resale agreements and Securities borrowed

reflected a higher level of funds that were available for short-term investment opportunities and a higher volume of securities needed for trading purposes. The decrease in Federal funds purchased and securities sold under repurchase agreements was due primarily to a lower level of AFS securities in Treasury, partly offset by higher amounts to fund trading positions. For additional information on the Firm's Liquidity risk management, see pages 70–73 of this Annual Report.

#### Trading assets and liabilities – debt and equity instruments

The Firm uses debt and equity trading instruments for both market-making and proprietary risk-taking activities. These instruments consist primarily of fixed income securities, including government and corporate debt; equity, including convertible securities; loans; and physical commodities inventories. The increase in trading assets from December 31, 2006, was due primarily to the more active capital markets environment, with growth in client-driven market-making activities, particularly for debt securities. In addition, a total of \$33.8 billion of loans are now accounted for at fair value under SFAS 159 and classified as trading assets at December 31, 2007. The trading assets accounted for under SFAS 159 are primarily certain prime mortgage loans warehoused by RFS for sale or securitization purposes, and loans warehoused by IB. For additional information, refer to Note 5 and Note 6 on pages 119–121 and 122, respectively, of this Annual Report.

#### Trading assets and liabilities – derivative receivables and payables

The Firm utilizes various interest rate, foreign exchange, equity, credit and commodity derivatives for market-making, proprietary risk-taking and risk-management purposes. Both derivative receivables and derivative payables increased from December 31, 2006, primarily driven by increases in credit derivative and interest rate products due to increased credit spreads and lower interest rates, respectively, as well as a decline in the U.S. dollar. For additional information, refer to Derivative contracts, Note 6 and Note 30 on pages 79–82, 122 and 168–169, respectively, of this Annual Report.

#### Securities

Almost all of the Firm's securities portfolio is classified as AFS and is used primarily to manage the Firm's exposure to interest rate movements. The AFS portfolio decreased from December 31, 2006, primarily due to net sales and maturities of securities in Treasury. For additional information related to securities, refer to the Corporate segment discussion and to Note 12 on pages 59–60 and 134–136, respectively, of this Annual Report.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### Loans and Allowance for loan losses

The Firm provides loans to customers of all sizes, from large corporate and institutional clients to individual consumers. The Firm manages the risk/reward relationship of each portfolio and discourages the retention of loan assets that do not generate a positive return above the cost of risk-adjusted capital. Loans increased \$36.2 billion, or 8%, from December 31, 2006, primarily due to business growth in wholesale lending activity, mainly in IB, CB and AM; organic growth in the Home Equity portfolio; and the decision during the third quarter of 2007 to retain rather than sell subprime mortgage loans. These increases were offset partly by a decline in consumer loans as certain prime mortgage loans originated after January 1, 2007, are classified as Trading assets and accounted for at fair value under SFAS 159. In addition, certain loans warehoused in the IB were transferred to Trading assets on January 1, 2007, as part of the adoption of SFAS 159. The Allowance for loan losses increased \$2.0 billion, or 27%, from December 31, 2006. The consumer and wholesale components of the allowance increased \$1.5 billion and \$443 million, respectively. The increase in the consumer portion of the allowance was due to increases of \$1.2 billion in RFS, reflecting higher estimated losses related to home equity and subprime mortgage loans, and \$231 million in CS, reflecting a higher level of estimated net charge-offs in the credit card portfolio. The increase in the wholesale portion of the allowance was primarily due to loan growth in IB and CB. For a more detailed discussion of the loan portfolio and the Allowance for loan losses, refer to Credit risk management on pages 73–89 of this Annual Report.

### Goodwill

Goodwill arises from business combinations and represents the excess of the cost of an acquired entity over the net fair value amounts assigned to assets acquired and liabilities assumed. The increase in Goodwill primarily resulted from certain acquisitions by TSS and CS, and currency translation adjustments on the Sears Canada credit card acquisition. Partially offsetting these increases was a reduction resulting from the adoption of FIN 48, as well as tax-related purchase accounting adjustments. For additional information, see Notes 18 and 26 on pages 154–157 and 164–165, respectively, of this Annual Report.

### Other intangible assets

The Firm's other intangible assets consist of MSRs, purchased credit card relationships, other credit card-related intangibles, core deposit intangibles and all other intangibles. The slight decline in Other intangible assets reflects amortization, primarily related to credit card business-related intangibles and core deposit intangibles. This decrease was offset largely by an increase in the MSR asset, as additions from loan sales and purchases were offset partially by fair value changes reflecting modeled servicing portfolio runoff and negative fair value adjustments, as declining interest rates during the second half of 2007 drove an increase in estimated future prepayments. For additional information on MSRs and other intangible assets, see RFS's Mortgage Banking business discussion and Note 18 on pages 46–47 and 154–157 of this Annual Report.

### Deposits

The Firm's deposits represent a liability to customers, both retail and wholesale, for funds held on their behalf. Deposits are generally classified by location (U.S. and non-U.S.), whether they are interest or noninterest-bearing, and by type (i.e., demand, money market deposit accounts, savings, time or negotiable order of withdrawal accounts). Deposits help provide a stable and consistent source of funding for the Firm. Deposits rose from December 31, 2006, primarily due to a net increase in wholesale interest-bearing deposits in TSS, AM and CB, driven by growth in business volumes. For more information on deposits, refer to the RFS, TSS, and AM segment discussions and the Liquidity risk management discussion on pages 43–48, 54–55, 56–58, and 70–73, respectively, of this Annual Report. For more information on wholesale liability balances, including deposits, refer to the CB and TSS segment discussions on pages 52–53 and 54–55, respectively, of this Annual Report.

### Commercial paper and other borrowed funds

The Firm utilizes Commercial paper and other borrowed funds as part of its liquidity management activities to cover short-term funding needs, and in connection with TSS's cash management product whereby clients' excess funds, primarily in TSS, CB and RFS, are transferred into commercial paper overnight sweep accounts. The increases in Commercial paper and other borrowed funds were due primarily to the Firm's ongoing efforts to build further liquidity, growth in the volume of liability balances in sweep accounts and higher short-term requirements to fund trading positions. For additional information on the Firm's Liquidity risk management, see pages 70–73 of this Annual Report.

### Long-term debt and trust preferred capital debt securities

The Firm utilizes Long-term debt and trust preferred capital debt securities to build liquidity as part of its longer-term liquidity and capital management activities. Long-term debt and trust preferred capital debt securities increased from December 31, 2006, reflecting net new issuances, including client-driven structured notes in the IB. For additional information on the Firm's long-term debt activities, see the Liquidity risk management discussion on pages 70–73 of this Annual Report.

### Stockholders' equity

Total stockholders' equity increased \$7.4 billion from year-end 2006 to \$123.2 billion at December 31, 2007. The increase was primarily the result of Net income for 2007, net shares issued under the Firm's employee stock-based compensation plans, and the cumulative effect on Retained earnings of changes in accounting principles of \$915 million. These were offset partially by stock repurchases and the declaration of cash dividends. The \$915 million increase in Retained earnings resulting from the adoption of new accounting principles primarily reflected \$287 million related to SFAS 157, \$199 million related to SFAS 159 and \$436 million related to FIN 48 in the first quarter of 2007. For a further discussion of capital, see the Capital management section that follows; for a further discussion of the accounting changes, see Accounting and Reporting Developments on page 99, Note 4 on pages 111–118, Note 5 on pages 119–121 and Note 26 on pages 164–165 of this Form Annual Report.

## CAPITAL MANAGEMENT

The Firm's capital management framework is intended to ensure that there is capital sufficient to support the underlying risks of the Firm's business activities and to maintain "well-capitalized" status under regulatory requirements. In addition, the Firm holds capital above these requirements in amounts deemed appropriate to achieve management's regulatory and debt rating objectives. The process of assigning equity to the lines of business is integrated into the Firm's capital framework and is overseen by ALCO.

### Line of business equity

The Firm's framework for allocating capital is based upon the following objectives:

- integrate firmwide capital management activities with capital management activities within each of the lines of business;
- measure performance consistently across all lines of business; and
- provide comparability with peer firms for each of the lines of business.

Equity for a line of business represents the amount the Firm believes the business would require if it were operating independently, incorporating sufficient capital to address economic risk measures, regulatory capital requirements and capital levels for similarly rated peers. Capital is also allocated to each line of business for, among other things, goodwill associated with such line of business' acquisitions since the Merger. In management's view, this methodology assigns responsibility to the lines of business to generate returns on the amount of capital supporting acquisition-related goodwill. At the time of the Merger, the Firm assigned to the Corporate segment an amount of equity capital equal to the then-current book value of goodwill from and prior to the Merger. Return on equity is measured and internal targets for expected returns are established as a key measure of a business segment's performance. The Firm may revise its equity capital-allocation methodology again in the future.

In accordance with SFAS 142, the lines of business perform the required goodwill impairment testing. For a further discussion of goodwill and impairment testing, see Critical accounting estimates and Note 18 on pages 96–98 and 154–157, respectively, of this Annual Report.

Line of business equity (in billions)	Yearly Average	
	2007	2006
Investment Bank	\$ 21.0	\$ 20.8
Retail Financial Services	16.0	14.6
Card Services	14.1	14.1
Commercial Banking	6.5	5.7
Treasury & Securities Services	3.0	2.3
Asset Management	3.9	3.5
Corporate <sup>(a)</sup>	54.2	49.7
<b>Total common stockholders' equity</b>	<b>\$ 118.7</b>	<b>\$ 110.7</b>

(a) 2007 and 2006 include \$41.7 billion of equity to offset goodwill and \$12.5 billion and \$8.0 billion, respectively, of equity, primarily related to Treasury, Private Equity and the Corporate Pension Plan.

### Economic risk capital

JPMorgan Chase assesses its capital adequacy relative to the risks underlying the Firm's business activities, utilizing internal risk-assessment methodologies. The Firm measures economic capital primarily based upon four risk factors: credit risk, market risk, operational risk and private equity risk, principally for the Firm's private equity business.

Economic risk capital (in billions)	Yearly Average	
	2007	2006
Credit risk <sup>(a)</sup>	\$ 30.0	\$ 26.7
Market risk	9.5	9.9
Operational risk	5.6	5.7
Private equity risk	3.7	3.4
<b>Economic risk capital</b>	<b>48.8</b>	<b>45.7</b>
Goodwill	45.2	43.9
Other <sup>(b)</sup>	24.7	21.1
<b>Total common stockholders' equity</b>	<b>\$ 118.7</b>	<b>\$ 110.7</b>

(a) Incorporates a change to the wholesale credit risk methodology, which has been modified to include a through-the-cycle adjustment (described below). The prior period has been revised to reflect this methodology change.

(b) Reflects additional capital required, in management's view, to meet its regulatory and debt rating objectives.

### Credit risk capital

Credit risk capital is estimated separately for the wholesale businesses (IB, CB, TSS and AM) and consumer businesses (RFS and CS).

Credit risk capital for the overall wholesale credit portfolio is defined in terms of unexpected credit losses, both from defaults and declines in the portfolio value due to credit deterioration, measured over a one-year period at a confidence level consistent with the level of capitalization necessary to achieve a targeted "AA" credit rating. Unexpected losses are losses in excess of those for which provisions for credit losses are maintained. The capital methodology is based upon several principal drivers of credit risk: exposure at default (or loan-equivalent amount), default likelihood, credit spreads, loss severity and portfolio correlation.

In 2007, an updated capital methodology was introduced for credit exposures in the IB and for certain non-IB credit exposures related to publicly traded entities. The updated methodology includes a through-the-cycle adjustment to capital levels that reflects capital that would be needed across the various credit cycles. Capital methodologies employed across all wholesale businesses now employ a through-the-cycle approach.

Credit risk capital for the consumer portfolio is based upon product and other relevant risk segmentation. Actual segment level default and severity experience are used to estimate unexpected losses for a one-year horizon at a confidence level equivalent to the targeted "AA" credit rating. Statistical results for certain segments or portfolios are adjusted to ensure that capital is consistent with external benchmarks, such as subordination levels on market transactions or capital held at representative monoline competitors, where appropriate.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### Market risk capital

The Firm calculates market risk capital guided by the principle that capital should reflect the risk of loss in the value of portfolios and financial instruments caused by adverse movements in market variables, such as interest and foreign exchange rates, credit spreads, securities prices and commodities prices. Daily Value-at-Risk ("VAR"), monthly stress-test results and other factors are used to determine appropriate capital levels. The Firm allocates market risk capital to each business segment according to a formula that weights that segment's VAR and stress-test exposures. See Market risk management on pages 90–94 of this Annual Report for more information about these market risk measures.

### Operational risk capital

Capital is allocated to the lines of business for operational risk using a risk-based capital allocation methodology which estimates operational risk on a bottom-up basis. The operational risk capital model is based upon actual losses and potential scenario-based stress losses, with adjustments to the capital calculation to reflect changes in the quality of the control environment or the use of risk-transfer products. The Firm believes its model is consistent with the new Basel II Framework and expects to propose it for qualification under the Basel II advanced measurement approach for operational risk.

### Private equity risk capital

Capital is allocated to privately and publicly held securities, third-party fund investments and commitments in the Private Equity portfolio to cover the potential loss associated with a decline in equity markets and related asset devaluations. In addition to negative market fluctuations, potential losses in private equity investment portfolios can be magnified by liquidity risk. The capital allocation for the Private Equity portfolio is based upon measurement of the loss experience suffered by the Firm and other market participants over a prolonged period of adverse equity market conditions.

### Regulatory capital

The Board of Governors of the Federal Reserve System (the "Federal Reserve Board") establishes capital requirements, including well-capitalized standards for the consolidated financial holding company. The Office of the Comptroller of the Currency establishes similar capital requirements and standards for the Firm's national banks, including JPMorgan Chase Bank, N.A., and Chase Bank USA, N.A.

JPMorgan Chase maintained a well-capitalized position, based upon Tier 1 and Total capital ratios at December 31, 2007 and 2006 as indicated in the tables below.

#### Capital ratios

December 31,	2007	2006	Well-capitalized ratios
Tier 1 capital ratio	8.4%	8.7%	6.0%
Total capital ratio	12.6	12.3	10.0
Tier 1 leverage ratio	6.0	6.2	NA
Total stockholders' equity to assets	7.9	8.6	NA

#### Risk-based capital components and assets

December 31, (in millions)	2007	2006
Total Tier 1 capital	\$ 88,746	\$ 81,055
Total Tier 2 capital	43,496	34,210
<b>Total capital</b>	<b>\$ 132,242</b>	<b>\$ 115,265</b>
Risk-weighted assets	\$ 1,051,879	\$ 935,909
Total adjusted average assets	1,473,541	1,308,699

Tier 1 capital was \$88.7 billion at December 31, 2007, compared with \$81.1 billion at December 31, 2006, an increase of \$7.7 billion. The increase was due primarily to net income of \$15.4 billion; net issuances of common stock under the Firm's employee stock-based compensation plans of \$3.9 billion; net issuances of \$2.0 billion of qualifying trust preferred capital debt securities; and the after-tax effects of the adoption of new accounting principles reflecting increases of \$287 million for SFAS 157, \$199 million for SFAS 159 and \$436 million for FIN 48. These increases were partially offset by decreases in Stockholders' equity net of Accumulated other comprehensive income (loss) due to common stock repurchases of \$8.2 billion and dividends declared of \$5.2 billion. In addition, the change in capital reflects the exclusion of an \$882 million (after-tax) valuation adjustment to certain liabilities pursuant to SFAS 157 to reflect the credit quality of the Firm. Additional information regarding the Firm's capital ratios and the federal regulatory capital standards to which it is subject is presented in Note 28 on pages 166–167 of this Annual Report.

## Basel II

The minimum risk-based capital requirements adopted by the federal banking agencies follow the Capital Accord of the Basel Committee on Banking Supervision. In 2004, the Basel Committee published a revision to the Accord ("Basel II"). The goal of the new Basel II Framework is to provide more risk-sensitive regulatory capital calculations and promote enhanced risk management practices among large, internationally active banking organizations. U.S. banking regulators published a final Basel II rule in December 2007, which will require JPMorgan Chase to implement Basel II at the holding company level, as well as at certain key U.S. bank subsidiaries.

Prior to full implementation of the new Basel II Framework, JPMorgan Chase will be required to complete a qualification period of four consecutive quarters during which it will need to demonstrate that it meets the requirements of the new rule to the satisfaction of its primary U.S. banking regulators. The U.S. implementation timetable consists of the qualification period, starting any time between April 1, 2008, and April 1, 2010, followed by a minimum transition period of three years. During the transition period Basel II risk-based capital requirements cannot fall below certain floors based on current ("Basel I") regulations. JPMorgan Chase expects to be in compliance with all relevant Basel II rules within the established timelines. In addition, the Firm will continue to adopt Basel II rules in certain non-U.S. jurisdictions, as required.

## Dividends

The Firm's common stock dividend policy reflects JPMorgan Chase's earnings outlook, desired dividend payout ratios, need to maintain an adequate capital level and alternative investment opportunities. The Firm continues to target a dividend payout ratio of approximately 30–40% of Net income over time. On April 17, 2007, the Board of Directors increased the quarterly dividend to \$0.38 per share.

The following table shows the common dividend payout ratio based upon reported Net income.

### Common dividend payout ratio

Year ended December 31,	2007	2006	2005
Common dividend payout ratio	34%	34%	57%

For information regarding restrictions on JPMorgan Chase's ability to pay dividends, see Note 27 on pages 165–166 of this Annual Report.

## Stock repurchases

On April 17, 2007, the Board of Directors approved a stock repurchase program that authorizes the repurchase of up to \$10.0 billion of the Firm's common shares, which supersedes an \$8.0 billion stock repurchase program approved in 2006. The \$10.0 billion authorization includes shares to be repurchased to offset issuances under the Firm's employee stock-based plans. The actual number of shares repurchased is subject to various factors, including market conditions; legal considerations affecting the amount and timing of repurchase activity; the Firm's capital position (taking into account goodwill and intangibles); internal capital generation; and alternative potential investment opportunities. The repurchase program does not include specific price targets or timetables, may be executed through open market purchases or privately negotiated transactions, or utilizing Rule 10b5-1 programs, and may be suspended at any time.

For the year ended December 31, 2007, under the respective stock repurchase programs then in effect, the Firm repurchased a total of 168 million shares for \$8.2 billion at an average price per share of \$48.60. During 2006, under the respective stock repurchase programs then in effect, the Firm repurchased 91 million shares for \$3.9 billion at an average price per share of \$43.41.

As of December 31, 2007, \$6.2 billion of authorized repurchase capacity remained under the current stock repurchase program.

The Firm has determined that it may, from time to time, enter into written trading plans under Rule 10b5-1 of the Securities Exchange Act of 1934 to facilitate the repurchase of common stock in accordance with the repurchase program. A Rule 10b5-1 repurchase plan allows the Firm to repurchase shares during periods when it would not otherwise be repurchasing common stock – for example, during internal trading "black-out periods." All purchases under a Rule 10b5-1 plan must be made according to a predefined plan that is established when the Firm is not aware of material nonpublic information.

For additional information regarding repurchases of the Firm's equity securities, see Part II, Item 5, Market for registrant's common equity, related stockholder matters and issuer purchases of equity securities, on pages 13–14 of JPMorgan Chase's 2007 Form 10-K.

## OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL CASH OBLIGATIONS

JPMorgan Chase is involved with several types of off-balance sheet arrangements, including special purpose entities ("SPEs") and lending-related financial instruments (e.g., commitments and guarantees).

### Special-purpose entities

The basic SPE structure involves a company selling assets to the SPE. The SPE funds the purchase of those assets by issuing securities to investors in the form of commercial paper, short-term asset-backed notes, medium-term notes and other forms of interest. SPEs are generally structured to insulate investors from claims on the SPE's assets by creditors of other entities, including the creditors of the seller of the assets.

SPEs are an important part of the financial markets, providing market liquidity by facilitating investors' access to specific portfolios of assets and risks. These arrangements are integral to the markets for mortgage-backed securities, commercial paper and other asset-backed securities.

JPMorgan Chase uses SPEs as a source of liquidity for itself and its clients by securitizing financial assets, and by creating investment products for clients. The Firm is involved with SPEs through multi-seller conduits and investor intermediation activities, and as a result of its loan securitizations, through qualifying special purpose entities ("QSPEs"). This discussion focuses mostly on multi-seller conduits and investor intermediation. For a detailed discussion of all SPEs with which the Firm is involved, and the related accounting, see Note 1 on page 108, Note 16 on pages 139–145 and Note 17 on pages 146–154 of this Annual Report.

The Firm holds capital, as deemed appropriate, against all SPE-related transactions and related exposures, such as derivative transactions and lending-related commitments and guarantees.

The Firm has no commitments to issue its own stock to support any SPE transaction, and its policies require that transactions with SPEs be conducted at arm's length and reflect market pricing. Consistent with this policy, no JPMorgan Chase employee is permitted to invest in SPEs with which the Firm is involved where such investment would violate the Firm's Code of Conduct. These rules prohibit employees from self-dealing and acting on behalf of the Firm in transactions with which they or their family have any significant financial interest.

#### *Implications of a credit rating downgrade to JPMorgan Chase Bank, N.A.*

For certain liquidity commitments to SPEs, the Firm could be required to provide funding if the short-term credit rating of JPMorgan Chase Bank, N.A., was downgraded below specific levels, primarily "P-1", "A-1" and "F1" for Moody's, Standard & Poor's and Fitch, respectively. The amount of these liquidity commitments was \$94.0 billion and \$74.4 billion at December 31, 2007 and 2006, respectively. Alternatively, if JPMorgan Chase Bank, N.A., were downgraded, the Firm could be replaced by another liquidity provider in lieu of providing funding under the liquidity commitment, or in certain circumstances, the Firm could facilitate the sale or refinancing of the assets

in the SPE in order to provide liquidity. These commitments are included in other unfunded commitments to extend credit and asset purchase agreements, as shown in the Off-balance sheet lending-related financial instruments and guarantees table on page 68 of this Annual Report.

As noted above, the Firm is involved with three types of SPEs. A summary of each type of SPE follows.

#### *Multi-seller conduits*

The Firm helps customers meet their financing needs by providing access to the commercial paper markets through VIEs known as multi-seller conduits. Multi-seller conduit entities are separate bankruptcy-remote entities that purchase interests in, and make loans secured by, pools of receivables and other financial assets pursuant to agreements with customers of the Firm. The conduits fund their purchases and loans through the issuance of highly rated commercial paper to third-party investors. The primary source of repayment of the commercial paper is the cash flow from the pools of assets. JPMorgan Chase receives fees related to the structuring of multi-seller conduit transactions and receives compensation from the multi-seller conduits for its role as administrative agent, liquidity provider, and provider of program-wide credit enhancement.

#### *Investor intermediation*

As a financial intermediary, the Firm creates certain types of VIEs and also structures transactions, typically derivative structures, with these VIEs to meet investor needs. The Firm may also provide liquidity and other support. The risks inherent in derivative instruments or liquidity commitments are managed similarly to other credit, market and liquidity risks to which the Firm is exposed. The principal types of VIEs the Firm uses in these structuring activities are municipal bond vehicles, credit-linked note vehicles and collateralized debt obligations vehicles.

#### *Loan Securitizations*

JPMorgan Chase securitizes and sells a variety of its consumer and wholesale loans, including warehouse loans that are classified in Trading assets, through SPEs that are structured to meet the definition of a QSPE (as discussed in Note 1 on page 108 of this Annual Report). The primary purpose of these vehicles is to meet investor needs and to generate liquidity for the Firm through the sale of the loans to the QSPEs. Consumer activities include securitizations of residential real estate, credit card, automobile and education loans that are originated or purchased by RFS and CS. Wholesale activities include securitizations of purchased residential real estate loans and commercial loans (primarily real estate-related) originated by the IB.

#### *Consolidation and consolidation sensitivity analysis on capital*

For more information regarding these programs and the Firm's other SPEs, as well as the Firm's consolidation analysis for these programs, see Note 16 and Note 17 on pages 139–145 and 146–154, respectively, of this Annual Report.

### Special-purpose entities revenue

The following table summarizes certain revenue information related to consolidated and nonconsolidated VIEs and QSPEs with which the Firm has significant involvement. The revenue reported in the table below primarily represents contractual servicing and credit fee income (i.e., for income from acting as administrator, structurer, liquidity provider). It does not include mark-to-market gains and losses from changes in the fair value of trading positions (such as derivative transactions) entered into with VIEs. Those gains and losses are recorded in Principal transactions revenue.

### Revenue from VIEs and QSPEs

Year ended December 31,

(in millions)

	2007	2006	2005
<b>VIEs:</b> <sup>(a)</sup>			
Multi-seller conduits	\$ 187 <sup>(b)</sup>	\$ 160	\$ 172
Investor intermediation	33	49	50
<b>Total VIEs</b>	<b>220</b>	<b>209</b>	<b>222</b>
<b>QSPEs</b>	<b>3,479</b>	<b>3,183</b>	<b>2,940</b>
<b>Total</b>	<b>\$ 3,699</b>	<b>\$3,392</b>	<b>\$ 3,162</b>

(a) Includes revenue associated with consolidated VIEs and significant nonconsolidated VIEs.

(b) Excludes the markdown on subprime CDO assets that was recorded in Principal transaction revenue during the fourth quarter of 2007.

### American Securitization Forum subprime adjustable rate mortgage loans modifications

In December 2007, the American Securitization Forum ("ASF") issued the "Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans" ("the Framework"). The Framework provides guidance for servicers to streamline evaluation procedures of borrowers with certain subprime adjustable rate mortgage ("ARM") loans to more quickly and efficiently provide modification of such loans with terms that are more appropriate for the individual needs of such borrowers. The Framework applies to all first-lien subprime ARM loans that have a fixed rate of interest for an initial period of 36 months or less, are included in securitized pools, were originated between January 1, 2005, and July 31, 2007, and have an initial interest rate reset date between January 1, 2008, and July 31, 2010. JPMorgan Chase has adopted the Framework, and it expects to begin modifying eligible loans by the end of the first quarter of 2008. For additional discussion of the Framework, see Note 16 on page 145 of this Annual Report.

### Off-balance sheet lending-related financial instruments and guarantees

JPMorgan Chase utilizes lending-related financial instruments (e.g., commitments and guarantees) to meet the financing needs of its customers. The contractual amount of these financial instruments represents the maximum possible credit risk should the counterparty draw upon the commitment or the Firm be required to fulfill its obligation under the guarantee, and the counterparty subsequently fail to perform according to the terms of the contract. Most of these commitments and guarantees expire without a default occurring or without being drawn. As a result, the total contractual amount of these instruments is not, in the Firm's view, representative of its actual future credit exposure or funding requirements. Further, certain commitments, primarily related to consumer financings, are cancellable, upon notice, at the option of the Firm. For further discussion of lending-related commitments and guarantees and the Firm's accounting for them, see Credit risk management on pages 73–89 and Note 31 on pages 170–173 of this Annual Report.

### Contractual cash obligations

In the normal course of business, the Firm enters into various contractual obligations that may require future cash payments. Commitments for future cash expenditures primarily include contracts to purchase future services and capital expenditures related to real estate-related obligations and equipment.

The accompanying table summarizes, by remaining maturity, JPMorgan Chase's off-balance sheet lending-related financial instruments and significant contractual cash obligations at December 31, 2007. Contractual purchases and capital expenditures in the table below reflect the minimum contractual obligation under legally enforceable contracts with terms that are both fixed and determinable. Excluded from the following table are a number of obligations to be settled in cash, primarily in under one year. These obligations are reflected on the Firm's Consolidated balance sheets and include Federal funds purchased and securities sold under repurchase agreements; Commercial paper; Other borrowed funds; purchases of Debt and equity instruments; Derivative payables; and certain purchases of instruments that resulted in settlement failures. Also excluded are contingent payments associated with certain acquisitions that could not be estimated. For discussion regarding Long-term debt and trust preferred capital debt securities, see Note 21 on pages 159–160 of this Annual Report. For discussion regarding operating leases, see Note 29 on page 167 of this Annual Report.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

The following table presents maturity information for off-balance sheet lending-related financial instruments and guarantees.

### Off-balance sheet lending-related financial instruments and guarantees

By remaining maturity at December 31, (in millions)	2007					2006
	2008	2009-2010	2011-2012	After 2012	Total	Total
<b>Lending-related</b>						
Consumer <sup>(a)</sup>	\$ 740,080	\$ 2,852	\$ 3,222	\$ 69,782	\$ 815,936	\$ 747,535
Wholesale:						
Other unfunded commitments to extend credit <sup>(b)(c)(d)(e)</sup>	97,459	61,710	73,725	18,060	250,954	229,204
Asset purchase agreements <sup>(f)</sup>	28,521	45,087	14,171	2,326	90,105	67,529
Standby letters of credit and guarantees <sup>(c)(g)(h)</sup>	24,970	26,704	40,792	7,756	100,222	89,132
Other letters of credit <sup>(c)</sup>	4,463	792	109	7	5,371	5,559
<b>Total wholesale</b>	<b>155,413</b>	<b>134,293</b>	<b>128,797</b>	<b>28,149</b>	<b>446,652</b>	<b>391,424</b>
<b>Total lending-related</b>	<b>\$ 895,493</b>	<b>\$ 137,145</b>	<b>\$ 132,019</b>	<b>\$ 97,931</b>	<b>\$ 1,262,588</b>	<b>\$ 1,138,959</b>
<b>Other guarantees</b>						
Securities lending guarantees <sup>(i)</sup>	\$ 385,758	\$ —	\$ —	\$ —	\$ 385,758	\$ 318,095
Derivatives qualifying as guarantees <sup>(j)</sup>	26,541	8,543	24,556	25,622	85,262	71,531

### Contractual cash obligations

By remaining maturity at December 31,  
(in millions)

Time deposits	\$ 243,923	\$ 3,246	\$ 2,108	\$ 600	\$ 249,877	\$ 204,349
Long-term debt	28,941	55,797	36,042	63,082	183,862	133,421
Trust preferred capital debt securities	—	—	—	15,148	15,148	12,209
FIN 46R long-term beneficial interests <sup>(k)</sup>	35	79	2,070	5,025	7,209	8,336
Operating leases <sup>(l)</sup>	1,040	1,943	1,644	6,281	10,908	11,029
Contractual purchases and capital expenditures	1,597	576	131	130	2,434	1,584
Obligations under affinity and co-brand programs	1,092	2,231	2,079	75	5,477	6,115
Other liabilities <sup>(m)</sup>	690	937	917	3,112	5,656	5,302
<b>Total</b>	<b>\$ 277,318</b>	<b>\$ 64,809</b>	<b>\$ 44,991</b>	<b>\$ 93,453</b>	<b>\$ 480,571</b>	<b>\$ 382,345</b>

(a) Included credit card and home equity lending-related commitments of \$714.8 billion and \$74.2 billion, respectively, at December 31, 2007; and \$657.1 billion and \$69.6 billion, respectively, at December 31, 2006. These amounts for credit card and home equity lending-related commitments represent the total available credit for these products. The Firm has not experienced, and does not anticipate, that all available lines of credit for these products will be utilized at the same time. The Firm can reduce or cancel these lines of credit by providing the borrower prior notice or, in some cases, without notice as permitted by law.

(b) Includes unused advised lines of credit totaling \$38.4 billion and \$39.0 billion at December 31, 2007 and 2006, respectively, which are not legally binding. In regulatory filings with the Federal Reserve Board, unused advised lines are not reportable. See the Glossary of terms, on page 181 of this Annual Report, for the Firm's definition of advised lines of credit.

(c) Represents contractual amount net of risk participations totaling \$28.3 billion and \$32.8 billion at December 31, 2007 and 2006, respectively.

(d) Excludes unfunded commitments for private third-party equity investments of \$881 million and \$589 million at December 31, 2007 and 2006, respectively. Also excludes unfunded commitments for other equity investments of \$903 million and \$943 million at December 31, 2007 and 2006, respectively.

(e) Included in Other unfunded commitments to extend credit are commitments to investment and noninvestment grade counterparties in connection with leveraged acquisitions of \$8.2 billion at December 31, 2007.

(f) Largely represents asset purchase agreements to the Firm's administered multi-seller, asset-backed commercial paper conduits. The maturity is based upon the weighted-average life of the underlying assets in the SPE, which are primarily asset purchase agreements to the Firm's administered multi-seller asset-backed commercial paper conduits. It also includes \$1.1 billion and \$1.4 billion of asset purchase agreements to other third-party entities at December 31, 2007 and 2006, respectively.

(g) JPMorgan Chase held collateral relating to \$15.8 billion and \$13.5 billion of these arrangements at December 31, 2007 and 2006, respectively.

(h) Included unused commitments to issue standby letters of credit of \$50.7 billion and \$45.7 billion at December 31, 2007 and 2006, respectively.

(i) Collateral held by the Firm in support of securities lending indemnification agreements was \$390.5 billion and \$317.9 billion at December 31, 2007 and 2006, respectively.

(j) Represents notional amounts of derivatives qualifying as guarantees. For further discussion of guarantees, see Note 31 on pages 170–173 of this Annual Report.

(k) Included on the Consolidated balance sheets in Beneficial interests issued by consolidated variable interest entities.

(l) Excluded benefit of noncancelable sublease rentals of \$1.3 billion and \$1.2 billion at December 31, 2007 and 2006, respectively.

(m) Included deferred annuity contracts. Excludes contributions for pension and other postretirement benefits plans, if any, as these contributions are not reasonably estimable at this time. Also excluded are unrecognized tax benefits of \$4.8 billion at December 31, 2007, as the timing and amount of future cash payments is not determinable at this time.

## RISK MANAGEMENT

Risk is an inherent part of JPMorgan Chase's business activities. The Firm's risk management framework and governance structure are intended to provide comprehensive controls and ongoing management of the major risks inherent in the Firm's business activities. The Firm's ability to properly identify, measure, monitor and report risk is critical to both its soundness and profitability.

- **Risk identification:** The Firm's exposure to risk through its daily business dealings, including lending, trading and capital markets activities, is identified and aggregated through the Firm's risk management infrastructure.
- **Risk measurement:** The Firm measures risk using a variety of methodologies, including calculating probable loss, unexpected loss and value-at-risk, and by conducting stress tests and making comparisons to external benchmarks. Measurement models and related assumptions are routinely reviewed with the goal of ensuring that the Firm's risk estimates are reasonable and reflect underlying positions.
- **Risk monitoring/control:** The Firm's risk management policies and procedures incorporate risk mitigation strategies and include approval limits by customer, product, industry, country and business. These limits are monitored on a daily, weekly and monthly basis, as appropriate.
- **Risk reporting:** Risk reporting is executed on a line of business and consolidated basis. This information is reported to management on a daily, weekly and monthly basis, as appropriate. There are eight major risk types identified in the business activities of the Firm: liquidity risk, credit risk, market risk, interest rate risk, private equity risk, operational risk, legal and fiduciary risk, and reputation risk.

### Risk governance

The Firm's risk governance structure starts with each line of business being responsible for managing its own risks. Each line of business works closely with Risk Management through its own risk committee

and, in most cases, its own chief risk officer to manage risk. Each line of business risk committee is responsible for decisions regarding the business' risk strategy, policies and controls.

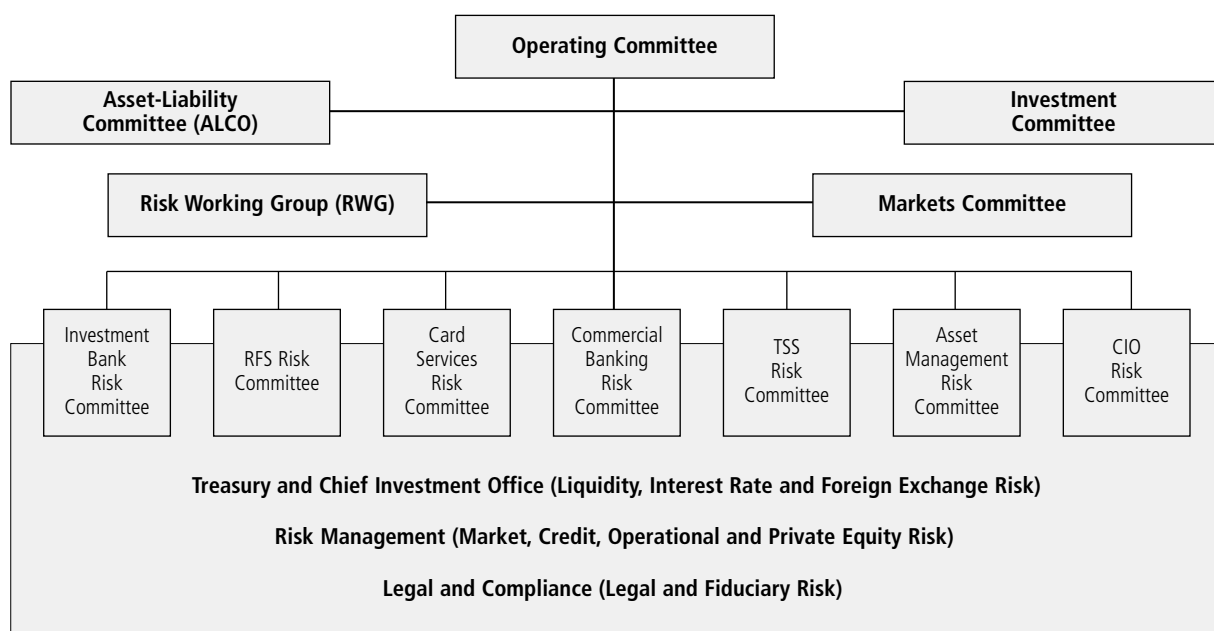
Overlaying the line of business risk management are four corporate functions with risk management-related responsibilities, including Treasury, the Chief Investment Office, Legal and Compliance and Risk Management.

Risk Management is headed by the Firm's Chief Risk Officer, who is a member of the Firm's Operating Committee and who reports to the Chief Executive Officer and the Board of Directors, primarily through the Board's Risk Policy Committee. Risk Management is responsible for providing a firmwide function of risk management and controls. Within Risk Management are units responsible for credit risk, market risk, operational risk and private equity risk, as well as Risk Management Services and Risk Technology and Operations. Risk Management Services is responsible for risk policy and methodology, risk reporting and risk education; and Risk Technology and Operations is responsible for building the information technology infrastructure used to monitor and manage risk.

Treasury and the Chief Investment Office are responsible for measuring, monitoring, reporting and managing the Firm's liquidity, interest rate and foreign exchange risk.

Legal and Compliance has oversight for legal and fiduciary risk.

In addition to the risk committees of the lines of business and the above-referenced corporate functions, the Firm also has an Investment Committee, an ALCO and two risk committees, namely, the Risk Working Group and the Markets Committee. The members of these committees are composed of senior management of the Firm, including representatives of line of business, Risk Management, Finance and other senior executives.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

The Investment Committee oversees global merger and acquisition activities undertaken by JPMorgan Chase for its own account that fall outside the scope of the Firm's private equity and other principal finance activities.

The Asset-Liability Committee is responsible for approving the Firm's liquidity policy, including contingency funding planning and exposure to SPEs (and any required liquidity support by the Firm of such SPEs). The Asset-Liability Committee also oversees the Firm's capital management and funds transfer pricing policy (through which lines of business "transfer" interest and foreign exchange risk to Treasury in the Corporate segment).

The Risk Working Group meets monthly to review issues such as risk policy, risk methodology, Basel II and regulatory issues and topics referred to it by any line of business risk committee. The Markets Committee, chaired by the Chief Executive Officer, meets weekly to

review and determine appropriate courses of action with respect to significant risk matters, including but not limited to: limits; credit, market and operational risk; large, high risk transactions; and hedging strategies.

The Board of Directors exercises its oversight of risk management, principally through the Board's Risk Policy Committee and Audit Committee. The Risk Policy Committee oversees senior management risk-related responsibilities, including reviewing management policies and performance against these policies and related benchmarks. The Audit Committee is responsible for oversight of guidelines and policies that govern the process by which risk assessment and management is undertaken. In addition, the Audit Committee reviews with management the system of internal controls and financial reporting that is relied upon to provide reasonable assurance of compliance with the Firm's operational risk management processes.

### LIQUIDITY RISK MANAGEMENT

The goal of liquidity risk management is to ensure that cost-effective funding is available to meet actual and contingent liquidity needs over time.

JPMorgan Chase uses a centralized approach for liquidity risk management. Global funding is managed by Treasury, using regional expertise as appropriate. Management believes that a centralized framework maximizes liquidity access, minimizes funding costs and permits global identification and coordination of liquidity risk.

#### Governance

ALCO approves and oversees the execution of the Firm's liquidity policy and contingency funding plan. Treasury formulates the Firm's liquidity and contingency planning strategies and is responsible for measuring, monitoring, reporting and managing the Firm's liquidity risk profile.

#### Liquidity monitoring and recent actions

Treasury monitors historical liquidity trends, tracks historical and prospective on- and off-balance sheet liquidity obligations, identifies and measures internal and external liquidity warning signals to permit early detection of liquidity issues, and manages contingency planning (including identification and testing of various company-specific and market-driven stress scenarios). Various tools, which together contribute to an overall liquidity perspective, are used to monitor and manage liquidity. These include analysis of the timing of liquidity sources versus liquidity uses (i.e., funding gaps) over periods ranging from overnight to one year; management of debt and capital issuance to ensure that the illiquid portion of the balance sheet can be funded by equity, long-term debt, trust preferred capital debt securities and deposits the Firm believes to be stable; and assessment of the Firm's capacity to raise incremental unsecured and secured funding.

Liquidity of the parent holding company and its nonbank subsidiaries is monitored separately from the Firm's bank subsidiaries. At the parent holding company level, long-term funding is managed to ensure that the parent holding company has sufficient liquidity to cover its obligations and those of its nonbank subsidiaries within the next 12 months. For bank subsidiaries, the focus of liquidity risk management is on maintenance of unsecured and secured funding capacity sufficient to meet on- and off-balance sheet obligations.

An extension of liquidity management is the Firm's contingency funding plan. The goal of the plan is to ensure appropriate liquidity during normal and stress periods. The plan considers various temporary and long-term stress scenarios where access to unsecured funding is severely limited or nonexistent, taking into account both on- and off-balance sheet exposures, and separately evaluates access to funds by the parent holding company, JPMorgan Chase Bank, N.A., Chase Bank USA, N.A., and J.P. Morgan Securities Inc.

In response to the market turmoil in the latter half of 2007, JPMorgan Chase took various actions to strengthen the Firm's liquidity position. In anticipation of possible incremental funding requirements that could have resulted from draws under unfunded revolving credit facilities and/or potential consolidation or purchase of assets from VIEs, the parent holding company increased issuance of commercial paper, long-term debt and trust preferred capital debt securities, and bank subsidiaries increased retail and wholesale unsecured funding liabilities. In addition, JPMorgan Chase Bank, N.A., maintained sufficient secured borrowing capacity, when aggregated with unsecured funding sources, to cover anticipated on- and off-balance sheet obligations of bank subsidiaries.

As of December 31, 2007, the Firm's liquidity position remained strong based upon its liquidity metrics.

## Funding

### Sources of funds

Management uses a variety of unsecured and secured funding sources to generate liquidity, taking into consideration, among other factors, market conditions, prevailing interest rates, liquidity needs and the desired maturity profile of liabilities. Markets are evaluated on an ongoing basis to achieve an appropriate global balance of unsecured and secured funding at favorable rates. The Firm's ability to generate funding from a broad range of sources in a variety of geographic locations enhances financial flexibility and limits dependence on any one source. Diversification of funding is an important component of the Firm's liquidity management strategy.

Deposits held by the RFS, CB, TSS and AM lines of business are generally a consistent source of unsecured funding for JPMorgan Chase Bank, N.A. As of December 31, 2007, total deposits for the Firm were \$740.7 billion. A significant portion of the Firm's deposits are retail deposits, which are less sensitive to interest rate changes and therefore are considered more stable than market-based wholesale deposits. The Firm also benefits from stable wholesale liability balances originated by CB, TSS and AM through the normal course of business. Such liability balances include deposits that are swept to on-balance sheet liabilities (e.g., Commercial paper, Federal funds purchased and securities sold under repurchase agreements). These liability balances are also a stable and consistent source of funding due to the nature of the businesses from which they are generated. For further discussions of deposit and liability balance trends, see the discussion of the results for the Firm's business segments and the Balance Sheet Analysis on pages 40–58 and 61–62, respectively, of this Annual Report.

Additional sources of unsecured funds include a variety of short- and long-term instruments, including federal funds purchased, commercial paper, bank notes, long-term debt and trust preferred capital debt securities. Decisions concerning timing of issuance and the tenor of liabilities are based upon relative costs, general market conditions, prospective views of balance sheet growth and a targeted liquidity profile.

Funding flexibility is also provided by the Firm's ability to access secured funding from the repurchase and asset securitization markets. The Firm maintains reserves of unencumbered liquid securities that can be financed to generate liquidity. The ability to obtain collateralized financing against liquid securities is dependent on prevailing market conditions. The ability to securitize loans, and the associated gains on those securitizations, are principally dependent upon the credit quality and yields of the assets securitized and are generally not dependent upon the credit ratings of the issuing entity. Transactions between the Firm and its securitization structures are reflected in JPMorgan Chase's consolidated financial statements and are discussed in the notes to the consolidated financial statements. These relationships generally include retained interests in securitization trusts, liquidity facilities and derivative transactions. For further details, see Off-balance sheet arrangements and contractual cash obligations, Note 16 and Note 31 on pages 66–68, 139–145 and 170–173, respectively, of this Annual Report.

Bank subsidiaries' access to the Federal Reserve Account Window is an additional source of secured funding; however, management does not view this as a primary means of funding the Firm's bank subsidiaries.

### Issuance

During 2007, JPMorgan Chase issued \$95.1 billion of long-term debt and trust preferred capital debt securities. These issuances included \$52.2 billion of IB structured notes, the issuances of which are generally client-driven and not for funding or capital management purposes, as the proceeds from such transactions are generally used to purchase securities to mitigate the risk associated with structured note exposure. The issuances of long-term debt and trust preferred capital debt securities were offset partially by \$49.4 billion of long-term debt and trust preferred capital debt securities that matured or were redeemed during 2007, including IB structured notes. The increase in Treasury-issued long-term debt and trust preferred capital debt securities was used primarily to fund certain illiquid assets held by the Parent company and to build liquidity. During 2007, Commercial paper increased \$30.7 billion and Other borrowed funds increased \$10.8 billion. The growth in both Commercial paper and Other borrowed funds was used to build liquidity further by increasing the amounts held of liquid securities and of overnight investments that may be readily converted to cash. In addition, during 2007, the Firm securitized \$28.9 billion of residential mortgage loans, \$21.2 billion of credit card loans and \$1.2 billion of education loans. The Firm did not securitize any auto loans during 2007. For further discussion of loan securitizations, see Note 16 on pages 139–145 of this Annual Report.

In connection with the issuance of certain of its trust preferred capital debt securities, the Firm has entered into Replacement Capital Covenants ("RCCs") granting certain rights to the holders of "covered debt," as defined in the RCCs, that prohibit the repayment, redemption or purchase of the trust preferred capital debt securities except, with limited exceptions, to the extent that JPMorgan Chase has received specified amounts of proceeds from the sale of certain qualifying securities. Currently the Firm's covered debt is its 5.875% Junior Subordinated Deferrable Interest Debentures, Series O, due in 2035. For more information regarding these covenants, reference is made to the respective RCCs entered into by the Firm in connection with the issuances of such trust preferred capital debt securities, which are filed with the U.S. Securities and Exchange Commission under cover of Forms 8-K.

### Cash flows

For the years ended December 31, 2007, 2006 and 2005, Cash and due from banks decreased \$268 million, and increased \$3.7 billion and \$1.5 billion, respectively. The following discussion highlights the major activities and transactions that affected JPMorgan Chase's cash flows during 2007, 2006 and 2005.

#### *Cash Flows from Operating Activities*

For the years ended December 31, 2007, 2006 and 2005, net cash used in operating activities was \$110.6 billion, \$49.6 billion and \$30.2 billion, respectively. JPMorgan Chase's operating assets and liabilities support the Firm's capital markets and lending activities, including the origination or purchase of loans initially designated as held-for-sale. During each of the three years ended December 31, 2007, net cash was used to fund loans held-for-sale primarily in the IB and RFS. In 2007, there was a significant decline in cash flows from IB loan

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

originations/purchases and sale/securitization activities as a result of the difficult wholesale securitization market and capital markets for leveraged financings, which were affected by a significant deterioration in liquidity in the credit markets in the second half of 2007. Cash flows in 2007 associated with RFS residential mortgage activities grew reflecting an increase in originations. The amount and timing of cash flows related to the Firm's operating activities may vary significantly in the normal course of business as a result of the level of client-driven activities, market conditions and trading strategies. Management believes cash flows from operations, available cash balances and the Firm's ability to generate cash through short- and long-term borrowings will be sufficient to fund the Firm's operating liquidity needs.

### *Cash Flows from Investing Activities*

The Firm's investing activities primarily involve AFS securities, loans initially designated as held-for-investment and Federal funds sold and securities purchased under resale agreements.

For the year ended December 31, 2007, net cash of \$73.1 billion was used in investing activities, primarily to fund purchases in Treasury's AFS securities portfolio to manage the Firm's exposure to interest rate movements; net additions to the wholesale retained loan portfolios in the IB, CB and AM, mainly as a result of business growth; a net increase in the consumer retained loan portfolio, primarily reflecting growth in RFS in home equity loans and net additions to RFS's subprime mortgage loans portfolio, which was affected by management's decision in the third quarter to retain (rather than sell) new subprime mortgages, and growth in prime mortgage loans originated by RFS and AM (and held in Corporate) that cannot be sold to U.S. government agencies or U.S. government-sponsored enterprises; and increases in securities purchased under resale agreements as a result of a higher level of cash available for short-term investment opportunities in connection with Treasury's efforts to build the Firm's liquidity. These net uses of cash were partially offset by cash proceeds received from sales and maturities of AFS securities; and credit card, residential mortgage, education and wholesale loan sales and securitization activities, which grew in 2007 despite the difficult conditions in the credit markets.

For the year ended December 31, 2006, net cash of \$99.6 billion was used in investing activities. Net cash was invested to fund net additions to the retained wholesale loan portfolio, mainly resulting from capital markets activity in IB leveraged financings; increases in CS loans reflecting strong organic growth; net additions in retail home equity loans; the acquisition of private-label credit card portfolios from Kohl's, BP and Pier 1 Imports, Inc.; the acquisition of Collegiate Funding Services, and Treasury purchases of AFS securities in connection with repositioning the portfolio in response to changes in interest rates. These uses of cash were partially offset by cash proceeds provided from credit card, residential mortgage, auto and wholesale loan sales and securitization activities; sales and maturities of AFS securities; the net decline in auto loans and leases, which was caused partially by management's decision to de-emphasize vehicle leasing; and the sale of the insurance business at the beginning of the second quarter.

For the year ended December 31, 2005, net cash of \$12.9 billion was used in investing activities, primarily attributable to growth in consumer loans, primarily home equity and in CS, reflecting growth in new account originations and the acquisition of the Sears Canada credit card business, partially offset by securitization activity and a decline in auto loans reflecting a difficult auto lending market. Net cash was generated by the Treasury investment securities portfolio primarily from maturities of securities, as purchases and sales of securities essentially offset each other.

### *Cash Flows from Financing Activities*

The Firm's financing activities primarily reflect transactions involving customer deposits and long-term debt (including client-driven structured notes in the IB), and its common stock and preferred stock.

In 2007, net cash provided by financing activities was \$183.0 billion due to a net increase in wholesale deposits from growth in business volumes, in particular, interest-bearing deposits at TSS, AM and CB; net issuances by Treasury of Long-term debt and trust preferred capital debt securities primarily to fund certain illiquid assets held by the Parent company and to build liquidity and by the IB from client-driven structured notes transactions; and growth in Commercial paper issuances and Other borrowed funds in Treasury due to growth in the volume of liability balances in sweep accounts, in TSS and CB, higher short-term requirements to fund trading positions and to further build liquidity. Cash was used to repurchase common stock and to pay dividends on common stock, including an increase in the quarterly dividend in the second quarter of 2007.

In 2006, net cash provided by financing activities was \$152.7 billion due to net cash received from growth in deposits, reflecting new retail account acquisitions and the ongoing expansion of the retail branch distribution network; higher wholesale business volumes; increases in securities sold under repurchase agreements to fund trading positions and higher AFS securities positions in Treasury; and net issuances of Long-term debt and trust preferred capital debt securities. The net cash provided was offset partially by the payment of cash dividends on stock and common stock repurchases.

In 2005, net cash provided by financing activities was \$45.1 billion due to: growth in deposits, reflecting new retail account acquisitions, the ongoing expansion of the retail branch distribution network and higher wholesale business volumes; and net new issuances of Long-term debt and trust preferred capital debt securities; offset partially by the payment of cash dividends and common stock repurchases.

## Credit ratings

The credit ratings of JPMorgan Chase's parent holding company and each of its significant banking subsidiaries as of December 31, 2007, were as follows.

	Short-term debt			Senior long-term debt		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
JPMorgan Chase & Co.	P-1	A-1+	F1+	Aa2	AA-	AA-
JPMorgan Chase Bank, N.A.	P-1	A-1+	F1+	Aaa	AA	AA-
Chase Bank USA, N.A.	P-1	A-1+	F1+	Aaa	AA	AA-

On February 14, 2007, S&P raised the senior long-term debt ratings on JPMorgan Chase & Co. and the principal bank subsidiaries to "AA-" and "AA", respectively, from "A+" and "AA-", respectively. S&P also raised the short-term debt rating of JPMorgan Chase & Co. to "A-1+" from "A-1". On February 16, 2007, Fitch raised the senior long-term debt ratings on JPMorgan Chase & Co. and the principal bank subsidiaries to "AA-" from "A+". Fitch also raised the short-term debt rating of JPMorgan Chase & Co. to "F1+" from "F1". On March 2, 2007, Moody's raised the senior long-term debt ratings on JPMorgan Chase & Co. and the operating bank subsidiaries to "Aa2" and "Aaa", respectively, from "Aa3" and "Aa2", respectively.

The cost and availability of unsecured financing are influenced by credit ratings. A reduction in these ratings could have an adverse effect on the Firm's access to liquidity sources, increase the cost of funds, trigger additional collateral requirements and decrease the number of investors and counterparties willing to lend. Key factors in maintaining high credit

ratings include a stable and diverse earnings stream, leading market positions, strong capital ratios, strong credit quality and risk management controls, diverse funding sources and disciplined liquidity monitoring procedures.

If the Firm's ratings were downgraded by one notch, the Firm estimates the incremental cost of funds and the potential loss of funding to be negligible. Additionally, the Firm estimates the additional funding requirements for VIEs and other third-party commitments would not be material. Currently, the Firm believes a downgrade is unlikely. For additional information on the impact of a credit ratings downgrade on the funding requirements for VIEs, and on derivatives and collateral agreements, see Special-purpose entities on pages 66–67 and Ratings profile of derivative receivables mark-to-market ("MTM") on page 81, of this Annual Report.

## CREDIT RISK MANAGEMENT

Credit risk is the risk of loss from obligor or counterparty default. The Firm provides credit (for example, through loans, lending-related commitments and derivatives) to customers of all sizes, from large corporate clients to the individual consumer. The Firm manages the risk/reward relationship of each credit extension and discourages the retention of assets that do not generate a positive return above the cost of the Firm's risk-adjusted capital. In addition, credit risk management includes the distribution of the Firm's wholesale syndicated loan originations into the marketplace (primarily to IB clients), with retained exposure held by the Firm averaging less than 10%. Wholesale loans generated by CB and AM are generally retained on the balance sheet. With regard to the consumer credit market, the Firm focuses on creating a portfolio that is diversified from both a product and a geographic perspective. Within the mortgage business, originated loans are either retained in the mortgage portfolio, or securitized and sold selectively to U.S. government agencies and U.S. government-sponsored enterprises.

### Credit risk organization

Credit risk management is overseen by the Chief Risk Officer and implemented within the lines of business. The Firm's credit risk management governance consists of the following functions:

- establishing a comprehensive credit risk policy framework
- calculating the allowance for credit losses and ensuring appropriate credit risk-based capital management

- assigning and managing credit authorities in connection with the approval of all credit exposure
- monitoring and managing credit risk across all portfolio segments
- managing criticized exposures

### Risk identification

The Firm is exposed to credit risk through lending and capital markets activities. Credit risk management works in partnership with the business segments in identifying and aggregating exposures across all lines of business.

### Risk measurement

To measure credit risk, the Firm employs several methodologies for estimating the likelihood of obligor or counterparty default. Losses generated by consumer loans are more predictable than wholesale losses, but are subject to cyclical and seasonal factors. Although the frequency of loss is higher on consumer loans than on wholesale loans, the severity of loss is typically lower and more manageable on a portfolio basis. As a result of these differences, methodologies for measuring credit risk vary depending on several factors, including type of asset (e.g., consumer installment versus wholesale loan), risk measurement parameters (e.g., delinquency status and credit bureau score versus wholesale risk rating) and risk management and collection processes (e.g., retail collection center versus centrally managed workout groups). Credit risk measurement is based upon the amount of exposure should the obligor or the counterparty default, the proba-

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

bility of default and the loss severity given a default event. Based upon these factors and related market-based inputs, the Firm estimates both probable and unexpected losses for the wholesale and consumer portfolios. Probable losses, reflected in the Provision for credit losses, primarily are based upon statistical estimates of credit losses as a result of obligor or counterparty default. However, probable losses are not the sole indicators of risk. If losses were entirely predictable, the probable loss rate could be factored into pricing and covered as a normal and recurring cost of doing business. Unexpected losses, reflected in the allocation of credit risk capital, represent the potential volatility of actual losses relative to the probable level of losses. Risk measurement for the wholesale portfolio is assessed primarily on a risk-rated basis; for the consumer portfolio, it is assessed primarily on a credit-scored basis.

### *Risk-rated exposure*

For portfolios that are risk-rated (generally held in IB, CB, TSS and AM), probable and unexpected loss calculations are based upon estimates of probability of default and loss given default. Probability of default is the expected default calculated on an obligor basis. Loss given default is an estimate of losses that are based upon collateral and structural support for each credit facility. Calculations and assumptions are based upon management information systems and methodologies which are under continual review. Risk ratings are assigned and reviewed on an ongoing basis by Credit Risk Management and revised, if needed, to reflect the borrowers' current risk profiles and the related collateral and structural positions.

### *Credit-scored exposure*

For credit-scored portfolios (generally held in RFS and CS), probable loss is based upon a statistical analysis of inherent losses over discrete periods of time. Probable losses are estimated using sophisticated portfolio modeling, credit scoring and decision-support tools to project credit risks and establish underwriting standards. In addition, common measures of credit quality derived from historical loss experience are used to predict consumer losses. Other risk characteristics evaluated include recent loss experience in the portfolios, changes in origination sources, portfolio seasoning, loss severity and underlying credit practices, including charge-off policies. These analyses are applied to the Firm's current portfolios in order to estimate delinquencies and severity of losses, which determine the amount of probable losses. These factors and analyses are updated on a quarterly basis.

### **Risk monitoring**

The Firm has developed policies and practices that are designed to preserve the independence and integrity of extending credit and are included to ensure credit risks are assessed accurately, approved properly, monitored regularly and managed actively at both the transaction and portfolio levels. The policy framework establishes credit approval authorities, concentration limits, risk-rating methodologies, portfolio review parameters and guidelines for management of distressed exposure. Wholesale credit risk is monitored regularly on both an aggregate portfolio level and on an individual customer basis. For consumer credit risk, the key focus items are trends and concentrations at the portfolio level, where potential problems can be remedied through changes in underwriting policies and portfolio guidelines. Consumer Credit Risk Management monitors trends against business expectations and industry benchmarks.

In order to meet credit risk management objectives, the Firm seeks to maintain a risk profile that is diverse in terms of borrower, product type, industry and geographic concentration. Management of the Firm's wholesale exposure is accomplished through loan syndication and participations, loan sales, securitizations, credit derivatives, use of master netting agreements and collateral and other risk-reduction techniques, which are further discussed in the following risk sections.

### **Risk reporting**

To enable monitoring of credit risk and decision-making, aggregate credit exposure, credit metric forecasts, hold-limit exceptions and risk profile changes are reported regularly to senior credit risk management. Detailed portfolio reporting of industry, customer and geographic concentrations occurs monthly, and the appropriateness of the allowance for credit losses is reviewed by senior management at least on a quarterly basis. Through the risk reporting and governance structure, credit risk trends and limit exceptions are provided regularly to, and discussed with, senior management, as mentioned on page 69 of this Annual Report.

### **2007 Credit risk overview**

Despite the volatile capital markets environment in the second half of 2007, the wholesale portfolio overall experienced continued low levels of nonperforming loans and criticized assets. However, in the second half of 2007, credit market liquidity levels declined significantly, which negatively affected loan syndication markets, resulting in an increase in funded and unfunded exposures, particularly related to leveraged lending, held on the balance sheet. This exposure is diversified across clients and industries and is performing, but subject to market volatility and potentially further writedowns. In response to these events, the Firm has strengthened underwriting standards with respect to its loan syndications and leveraged lending, consistent with evolving market practice. For additional information on unfunded leverage acquisitions related to loan syndications, see Note 31 on pages 170–173 of this Annual Report.

In 2007, the domestic consumer credit environment was also negatively affected by the deterioration in residential real estate valuations, leading to increased credit losses primarily for Home Equity and Subprime Mortgage loans with multiple risk elements ("risk layered loans"). The Firm responded to these changes in the credit environment through the elimination of certain products, changes and enhancements to credit underwriting criteria and refinement of pricing and risk management models.

More detailed discussion of the domestic consumer credit environment can be found on page 84 of this Annual Report.

## CREDIT PORTFOLIO

The following table presents JPMorgan Chase's credit portfolio as of December 31, 2007 and 2006. Total credit exposure at December 31, 2007, increased \$187.2 billion from December 31, 2006, reflecting an increase of \$106.1 billion in the wholesale credit portfolio and \$81.1 billion in the consumer credit portfolio as further described in the following pages. During 2007, lending-related commitments increased \$123.6 billion (\$55.2 billion and \$68.4 billion in the wholesale and consumer portfolios, respectively), managed loans increased \$42.0 billion (\$29.3 billion and \$12.7 billion in the wholesale and consumer portfolios, respectively) and derivatives increased \$21.5 billion. Within loans, RFS loans accounted for at lower of cost or fair value declined, as prime mortgage loans originated with the intent to sell after January 1, 2007, were classified as Trading assets and accounted for at fair value under SFAS 159. In addition, certain loans

warehoused in IB were transferred to Trading assets on January 1, 2007, as part of the adoption of SFAS 159. Also effective January 1, 2007, \$24.7 billion of prime mortgages held-for-investment purposes were transferred from RFS (\$19.4 billion) and AM (\$5.3 billion) to the Corporate sector for risk management purposes. While this transfer had no impact on the RFS, AM or Corporate financial results, the AM prime mortgages that were transferred are now reported in consumer mortgage loans.

In the table below, reported loans include loans accounted for at fair value and loans held-for-sale, which are carried at lower of cost or fair value with changes in value recorded in Noninterest revenue. However, these held-for-sale loans and loans accounted for at fair value are excluded from the average loan balances used for the net charge-off rate calculations.

### Total credit portfolio

As of or for the year ended December 31, (in millions, except ratios)	Credit exposure		Nonperforming assets <sup>(i)</sup>		Net charge-offs		Average annual net charge-off rate	
	2007	2006	2007	2006	2007	2006	2007	2006
<b>Total credit portfolio</b>								
Loans — retained <sup>(a)</sup>	\$ 491,736	\$ 427,876	\$ 3,536 <sup>(i)</sup>	\$ 1,957 <sup>(i)</sup>	\$ 4,538	\$ 3,042	1.00%	0.73%
Loans held-for-sale	18,899	55,251	45	120	—	—	NA	NA
Loans at fair value	8,739	—	5	—	—	—	NA	NA
Loans — reported <sup>(a)</sup>	\$ 519,374	\$ 483,127	\$ 3,586	\$ 2,077	\$ 4,538	\$ 3,042	1.00%	0.73%
Loans — securitized <sup>(b)</sup>	72,701	66,950	—	—	2,380	2,210	3.43	3.28
<b>Total managed loans<sup>(c)</sup></b>	<b>592,075</b>	<b>550,077</b>	<b>3,586</b>	<b>2,077</b>	<b>6,918</b>	<b>5,252</b>	<b>1.33</b>	<b>1.09</b>
Derivative receivables	77,136	55,601	29	36	NA	NA	NA	NA
<b>Total managed credit-related assets</b>	<b>669,211</b>	<b>605,678</b>	<b>3,615</b>	<b>2,113</b>	<b>6,918</b>	<b>5,252</b>	<b>1.33</b>	<b>1.09</b>
Lending-related commitments <sup>(d)(e)</sup>	1,262,588	1,138,959	NA	NA	NA	NA	NA	NA
Assets acquired in loan satisfactions	NA	NA	622	228	NA	NA	NA	NA
<b>Total credit portfolio</b>	<b>\$ 1,931,799</b>	<b>\$ 1,744,637</b>	<b>\$ 4,237</b>	<b>\$ 2,341</b>	<b>\$ 6,918</b>	<b>\$ 5,252</b>	<b>1.33%</b>	<b>1.09%</b>
Credit derivative hedges notional <sup>(f)</sup>	\$ (67,999)	\$ (50,733)	\$ (3)	\$ (16)	NA	NA	NA	NA
Collateral held against derivatives <sup>(g)</sup>	(9,824)	(6,591)	NA	NA	NA	NA	NA	NA
<b>Memo:</b>								
Nonperforming — purchased <sup>(h)</sup>	—	251	NA	NA	NA	NA	NA	NA

(a) Loans (other than those for which the SFAS 159 fair value option has been elected) are presented net of unearned income and net deferred loan fees of \$1.0 billion and \$1.3 billion at December 31, 2007 and 2006, respectively.

(b) Represents securitized credit card receivables. For further discussion of credit card securitizations, see Card Services on pages 49–51 of this Annual Report.

(c) Loans past-due 90 days and over and accruing includes credit card receivables — reported of \$1.5 billion and \$1.3 billion at December 31, 2007 and 2006, respectively, and related credit card securitizations of \$1.1 billion and \$962 million at December 31, 2007 and 2006, respectively.

(d) Included credit card and home equity lending-related commitments of \$714.8 billion and \$74.2 billion, respectively, at December 31, 2007; and \$657.1 billion and \$69.6 billion, respectively, at December 31, 2006. These amounts for credit card and home equity lending-related commitments represent the total available credit for these products. The Firm has not experienced, nor does it anticipate, all available lines of credit being used at the same time. The Firm can reduce or cancel these lines of credit by providing the borrower prior notice or, in some cases, without notice as permitted by law.

(e) Included unused advised lines of credit totaling \$38.4 billion and \$39.0 billion at December 31, 2007 and 2006, respectively, which are not legally binding. In regulatory filings with the Federal Reserve Board, unused advised lines are not reportable.

(f) Represents the net notional amount of protection purchased and sold of single-name and portfolio credit derivatives used to manage the credit exposures; these derivatives do not qualify for hedge accounting under SFAS 133. Includes \$31.1 billion and \$22.7 billion at December 31, 2007 and 2006, respectively, which represents the notional amount of structured portfolio protection; the Firm retains a minimal first risk of loss on this portfolio.

(g) Represents other liquid securities collateral held by the Firm as of December 31, 2007 and 2006, respectively.

(h) Represents distressed wholesale loans held-for-sale purchased as part of IB's proprietary activities, which are excluded from nonperforming assets. During the first quarter of 2007, the Firm elected the fair value option of accounting for this portfolio of nonperforming loans. These loans are classified as Trading assets at December 31, 2007.

(i) Excluded nonperforming assets related to (1) loans eligible for repurchase as well as loans repurchased from GNMA pools that are insured by U.S. government agencies of \$1.5 billion and \$1.2 billion at December 31, 2007 and 2006, respectively, and (2) education loans that are 90 days past due and still accruing, which are insured by U.S. government agencies under the Federal Family Education Loan Program, of \$279 million and \$219 million at December 31, 2007 and 2006, respectively. These amounts for GNMA and education loans are excluded, as reimbursement is proceeding normally.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### WHOLESALE CREDIT PORTFOLIO

As of December 31, 2007, wholesale exposure (IB, CB, TSS and AM) increased \$106.1 billion from December 31, 2006, due to increases in lending-related commitments of \$55.2 billion and loans of \$29.3 billion. The increase in overall lending activity was partly due to growth in leveraged lending funded and unfunded exposures, mainly in IB. For further discussion of unfunded leveraged exposures, see Note 31, on pages 170–173 of this Annual Report.

Partly offsetting these increases was the first-quarter transfer of \$11.7 billion of loans warehoused in IB to Trading assets upon the adoption of SFAS 159.

The \$21.5 billion Derivative receivables increase from December 31, 2006, was primarily driven by increases in credit derivative and interest rate products due to increased credit spreads and lower interest rates, respectively, as well as a decline in the U.S. dollar.

#### Wholesale

As of or for the year ended December 31,  
(in millions)

	Credit exposure		Nonperforming assets <sup>(e)</sup>	
	2007	2006	2007	2006
Loans retained <sup>(a)</sup>	\$ 189,427	\$ 161,235	\$ 464	\$ 387
Loans held-for-sale	14,910	22,507	45	4
Loans at fair value	8,739	—	5	—
Loans – reported <sup>(a)</sup>	\$ 213,076	\$ 183,742	\$ 514	\$ 391
Derivative receivables	77,136	55,601	29	36
<b>Total wholesale credit-related assets</b>	<b>290,212</b>	<b>239,343</b>	<b>543</b>	<b>427</b>
Lending-related commitments <sup>(b)</sup>	446,652	391,424	NA	NA
Assets acquired in loan satisfactions	NA	NA	73	3
<b>Total wholesale credit exposure</b>	<b>\$ 736,864</b>	<b>\$ 630,767</b>	<b>\$ 616</b>	<b>\$ 430</b>
Credit derivative hedges notional <sup>(c)</sup>	\$ (67,999)	\$ (50,733)	\$ (3)	\$ (16)
Collateral held against derivatives <sup>(d)</sup>	(9,824)	(6,591)	NA	NA
<b>Memo:</b>				
Nonperforming – purchased <sup>(e)</sup>	—	251	NA	NA

(a) As a result of the adoption of SFAS 159 in the first quarter of 2007, certain loans of \$11.7 billion were reclassified to trading assets and were excluded from wholesale loans reported. Includes loans greater than or equal to 90 days past due that continue to accrue interest. The principal balance of these loans totaled \$75 million and \$29 million at December 31, 2007 and 2006, respectively. Also see Note 5 on pages 119–121 and Note 14 on pages 137–138 of this Annual Report.

(b) Includes unused advised lines of credit totaling \$38.4 billion and \$39.0 billion at December 31, 2007 and 2006, respectively, which are not legally binding. In regulatory filings with the Federal Reserve Board, unused advised lines are not reportable.

(c) Represents the net notional amount of protection purchased and sold of single-name and portfolio credit derivatives used to manage the credit exposures; these derivatives do not qualify for hedge accounting under SFAS 133. Includes \$31.1 billion and \$22.7 billion at December 31, 2007 and 2006, respectively, which represents the notional amount of structured portfolio protection; the Firm retains a minimal first risk of loss on this portfolio.

(d) Represents other liquid securities collateral held by the Firm as of December 31, 2007 and 2006, respectively.

(e) Represents distressed loans held-for-sale purchased as part of IB's proprietary activities, which are excluded from nonperforming assets. During the first quarter of 2007, the Firm elected the fair value option of accounting for this portfolio of nonperforming loans. These loans are classified as Trading assets at December 31, 2007.

#### Net charge-offs (recoveries)

##### Wholesale

Year ended December 31,  
(in millions, except ratios)

	2007	2006
Loans – reported		
Net charge-offs (recoveries)	\$ 72	\$ (22)
Average annual net charge-off (recovery) rate <sup>(a)</sup>	0.04%	(0.01)%

(a) Excludes average wholesale loans held-for-sale and loans at fair value of \$18.6 billion and \$22.2 billion for the years ended December 31, 2007 and 2006, respectively.

Net charge-offs (recoveries) do not include gains from sales of nonperforming loans that were sold as shown in the following table. Gains from these sales were \$1 million and \$82 million during 2007 and 2006, respectively, which are reflected in Noninterest revenue.

#### Nonperforming loan activity

##### Wholesale

Year ended December 31,  
(in millions)

	2007	2006
<b>Beginning balance</b>	<b>\$ 391</b>	<b>\$ 992</b>
Additions	1,107	480
Reductions:		
Paydowns and other	(576)	(578)
Charge-offs	(185)	(186)
Returned to performing	(136)	(133)
Sales	(87)	(184)
<b>Total reductions</b>	<b>(984)</b>	<b>(1,081)</b>
<b>Net additions (reductions)</b>	<b>123</b>	<b>(601)</b>
<b>Ending balance</b>	<b>\$ 514</b>	<b>\$ 391</b>

The following table presents summaries of the maturity and ratings profiles of the wholesale portfolio as of December 31, 2007 and 2006. The ratings scale is based upon the Firm's internal risk ratings and generally correspond to the ratings as defined by S&P and Moody's.

### Wholesale credit exposure – maturity and ratings profile

December 31, 2007 (in billions, except ratios)	Maturity profile <sup>(c)</sup>				Ratings profile			
	<1 year	1–5 years	>5 years	Total	Investment-grade ("IG")	Noninvestment-grade	Total	Total % of IG
					AAA/Aaa to BBB-/Baa3	BB+/Ba1 & below		
Loans	44%	45%	11%	100%	\$ 127	\$ 62	\$ 189	67%
Derivative receivables	17	39	44	100	64	13	77	83
Lending-related commitments	35	59	6	100	380	67	447	85
<b>Total excluding loans held-for-sale and loans at fair value</b>	<b>36%</b>	<b>53%</b>	<b>11%</b>	<b>100%</b>	<b>\$ 571</b>	<b>\$ 142</b>	<b>713</b>	<b>80%</b>
Loans held-for-sale and loans at fair value <sup>(a)</sup>							24	
<b>Total exposure</b>							<b>\$ 737</b>	
Net credit derivative hedges notional <sup>(b)</sup>	39%	56%	5%	100%	\$ (61)	\$ (7)	\$ (68)	89%

December 31, 2006 (in billions, except ratios)	Maturity profile <sup>(c)</sup>				Ratings profile			
	<1 year	1–5 years	>5 years	Total	Investment-grade ("IG")	Noninvestment-grade	Total	Total % of IG
					AAA/Aaa to BBB-/Baa3	BB+/Ba1 & below		
Loans	44%	41%	15%	100%	\$ 104	\$ 57	\$ 161	65%
Derivative receivables	16	34	50	100	49	7	56	88
Lending-related commitments	36	58	6	100	338	53	391	86
<b>Total excluding loans held-for-sale and loans at fair value</b>	<b>37%</b>	<b>51%</b>	<b>12%</b>	<b>100%</b>	<b>\$ 491</b>	<b>\$ 117</b>	<b>608</b>	<b>81%</b>
Loans held-for-sale and loans at fair value <sup>(a)</sup>							23	
<b>Total exposure</b>							<b>\$ 631</b>	
Net credit derivative hedges notional <sup>(b)</sup>	16%	75%	9%	100%	\$ (45)	\$ (6)	\$ (51)	88%

(a) Loans held-for-sale relate primarily to syndication loans and loans transferred from the retained portfolio. During the first quarter of 2007, the Firm elected the fair value option of accounting for loans related to securitization activities, and these loans are classified as Trading assets.

(b) Ratings are based upon the underlying referenced assets. Represents the net notional amounts of protection purchased and sold of single-name and portfolio credit derivatives used to manage the credit exposures; these derivatives do not qualify for hedge accounting under SFAS 133. Includes \$31.1 billion and \$22.7 billion at December 31, 2007 and 2006, respectively, which represents the notional amount of structured portfolio protection; the Firm retains a minimal risk of losses on this portfolio.

(c) The maturity profile of Loans and lending-related commitments is based upon the remaining contractual maturity. The maturity profile of Derivative receivables is based upon the maturity profile of Average exposure. See page 80 of this Annual Report for a further discussion of Average exposure.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### Wholesale credit exposure – selected industry concentration

The Firm focuses on the management and the diversification of its industry concentrations, with particular attention paid to industries with actual or potential credit concerns. At December 31, 2007, the top 10 industries to which the Firm is exposed remained unchanged from December 31, 2006. The increases across all industries were

primarily due to portfolio growth. The notable rise in Asset managers was a result of portfolio growth and the Firm revising its industry classification during the third quarter of 2007 to better reflect risk correlations and enhance the Firm's management of industry risk. Below are summaries of the top 10 industry concentrations as of December 31, 2007 and 2006. For additional information on industry concentrations, see Note 32, on pages 173–174 of this Annual Report.

### Wholesale credit exposure – selected industry concentration

December 31, 2007 (in millions, except ratios)	Credit exposure <sup>(d)</sup>	Investment grade	Noninvestment-grade		Net charge-offs	Credit derivative hedges <sup>(e)</sup>	Collateral held against derivative receivables <sup>(f)</sup>
			Noncriticized	Criticized			
<b>Top 10 industries<sup>(a)</sup></b>							
Banks and finance companies	\$ 65,288	83%	\$ 10,385	\$ 498	\$ 5	\$ (6,368)	\$ (1,793)
Asset managers	38,554	90	3,518	212	—	(293)	(2,148)
Real estate	38,295	54	16,626	1,070	36	(2,906)	(73)
State and municipal governments	31,425	98	591	12	10	(193)	(3)
Healthcare	30,746	84	4,741	246	—	(4,241)	(10)
Consumer products	29,941	74	7,492	239	5	(4,710)	(13)
Utilities	28,679	89	3,021	212	1	(6,371)	(43)
Oil and gas	26,082	72	7,166	125	—	(4,007)	—
Retail and consumer services	23,969	68	7,149	550	3	(3,866)	(55)
Securities firms and exchanges	23,274	87	3,083	1	—	(467)	(1,321)
All other <sup>(b)</sup>	376,962	80	71,211	3,673	12	(34,577)	(4,365)
<b>Total excluding loans held-for-sale and loans at fair value</b>	<b>\$ 713,215</b>	<b>80%</b>	<b>\$ 134,983</b>	<b>\$ 6,838</b>	<b>\$ 72</b>	<b>\$ (67,999)</b>	<b>\$ (9,824)</b>

Loans held-for-sale and  
loans at fair value<sup>(c)</sup> **23,649**

**Total** **\$ 736,864**

December 31, 2006 (in millions, except ratios)	Credit exposure <sup>(d)</sup>	Investment grade	Noninvestment-grade		Net charge-offs	Credit derivative hedges <sup>(e)</sup>	Collateral held against derivative receivables <sup>(f)</sup>
			Noncriticized	Criticized			
<b>Top 10 industries<sup>(a)</sup></b>							
Banks and finance companies	\$ 61,792	84%	\$ 9,733	\$ 74	\$(12)	\$ (7,847)	\$ (1,452)
Asset managers	24,570	88	2,956	31	—	—	(750)
Real estate	32,102	57	13,702	243	9	(2,223)	(26)
State and municipal governments	27,485	98	662	23	—	(801)	(12)
Healthcare	28,998	83	4,618	284	(1)	(3,021)	(5)
Consumer products	27,114	72	7,327	383	22	(3,308)	(14)
Utilities	24,938	88	2,929	183	(6)	(4,123)	(2)
Oil and gas	18,544	76	4,356	38	—	(2,564)	—
Retail and consumer services	22,122	70	6,268	278	(3)	(2,069)	(226)
Securities firms and exchanges	23,127	93	1,527	5	—	(784)	(1,207)
All other <sup>(b)</sup>	317,468	80	58,971	3,484	(31)	(23,993)	(2,897)
<b>Total excluding loans held-for-sale and loans at fair value</b>	<b>\$ 608,260</b>	<b>81%</b>	<b>\$ 113,049</b>	<b>\$ 5,026</b>	<b>\$(22)</b>	<b>\$ (50,733)</b>	<b>\$ (6,591)</b>

Loans held-for-sale and  
loans at fair value<sup>(c)</sup> **22,507**

**Total** **\$ 630,767**

(a) Rankings are based upon exposure at December 31, 2007.

(b) For more information on exposures to SPEs included in All other, see Note 17 on pages 146–154 of this Annual Report.

(c) Loans held-for-sale relate primarily to syndication loans and loans transferred from the retained portfolio. During the first quarter of 2007, the Firm elected the fair value option of accounting for loans related to securitization activities; these loans are classified as Trading assets at December 31, 2007.

(d) Credit exposure is net of risk participations and excludes the benefit of credit derivative hedges and collateral held against Derivative receivables or Loans.

(e) Ratings are based upon the underlying referenced assets. Represents the net notional amounts of protection purchased and sold of single-name and portfolio credit derivatives used to manage the credit exposures; these derivatives do not qualify for hedge accounting under SFAS 133. Includes \$31.1 billion and \$22.7 billion at December 31, 2007 and 2006, respectively, which represents the notional amount of structured portfolio protection; the Firm retains a minimal risk of losses on this portfolio.

(f) Represents other liquid securities collateral held by the Firm as of December 31, 2007 and 2006, respectively.

## Wholesale criticized exposure

Exposures deemed criticized generally represent a ratings profile similar to a rating of "CCC+"/"Caa1" and lower, as defined by S&P and Moody's. The total criticized component of the portfolio, excluding loans held-for-sale and loans at fair value, increased to \$6.8 billion at December 31, 2007, from \$5.0 billion at year-end 2006. The increase was driven primarily by downgrades in the wholesale portfolio.

At December 31, 2007, Banks and finance companies, Building materials/ construction and Telecom services moved into the top 10 of wholesale criticized exposure, replacing Agriculture/paper manufacturing, Business services and Utilities.

Industry concentrations for wholesale criticized exposure as of December 31, 2007 and 2006, were as follows.

December 31, (in millions, except ratios)	2007		2006	
	Credit exposure	% of portfolio	Credit exposure	% of portfolio
<b>Top 10 industries<sup>(a)</sup></b>				
Automotive	\$ 1,338	20%	\$ 1,442	29%
Real estate	1,070	16	243	5
Retail and consumer services	550	8	278	5
Banks and finance companies	498	7	74	1
Building materials/construction	345	5	113	2
Media	303	4	392	8
Chemicals/plastics	288	4	159	3
Healthcare	246	4	284	6
Consumer products	239	4	383	7
Telecom services	219	3	20	1
All other	1,742	25	1,638	33
<b>Total excluding loans held-for-sale and loans at fair value</b>				
	\$ 6,838	100%	\$ 5,026	100%
Loans held-for-sale and loans at fair value <sup>(b)</sup>	205		624	
<b>Total</b>	<b>\$ 7,043</b>		<b>\$ 5,650</b>	

(a) Rankings are based upon exposure at December 31, 2007.

(b) Loans held-for-sale relate primarily to syndication loans and loans transferred from the retained portfolio. During the first quarter of 2007, the Firm elected the fair value option of accounting for loans related to securitization activities; these loans are classified as Trading assets at December 31, 2007. Loans held-for-sale exclude purchased nonperforming loans held-for-sale.

Presented below is a discussion of several industries to which the Firm has significant exposure, as well as industries the Firm continues to monitor because of actual or potential credit concerns. For additional information, refer to the tables above and on the preceding page.

- **Automotive:** Automotive Original Equipment Manufacturers and suppliers based in North America continued to be affected by a challenging operating environment in 2007. As a result, the industry continued to be the largest segment of the Firm's wholesale criticized exposure; however, most of the criticized exposure remains undrawn, is performing and is substantially secured.

- **Real estate:** Exposure to this industry grew in 2007 mainly due to growth in leveraged lending activity, primarily in the IB. On a portfolio basis, the Firm's Real estate exposure is well-diversified by client, transaction type, geography and property type. Approximately half of this exposure is to large public and rated real estate companies and institutions (e.g., REITS), as well as real estate loans originated for sale into the commercial mortgage-backed securities market. CMBS exposure totaled 5% of the category at December 31, 2007. These positions are actively risk managed. The remaining Real estate exposure is primarily to professional real estate developers, owners, or service providers and generally involves real estate leased to third-party tenants. Exposure to national and regional single-family home builders represents 16% of the category, down from 21% in 2006, and is considered to be at a manageable level. The increase in criticized exposure was largely a result of downgrades to a small group of homebuilders within the Real estate portfolio.

- **Retail and consumer services:** In 2007, criticized exposure to this industry increased as a result of downgrades of select portfolio names. Overall, the majority of the exposure remains rated investment grade and the portfolio is diversified by client, geography and product market served. The bigger portfolio names in terms of exposure tend to be large cap companies with access to capital markets. For smaller cap clients with more reliance on bank debt, exposures are often highly structured and/or secured.

- **Banks and finance companies:** This industry group, primarily consisting of exposure to commercial banks, is the largest segment of the Firm's wholesale credit portfolio. Even though criticized exposures grew in 2007 due to downgrades to select names within the portfolio, credit quality overall remained high, as 83% of the exposure in this category is rated investment grade.

- **All other:** All other in the wholesale credit exposure concentration table on page 78 of this Annual Report at December 31, 2007 (excluding loans held-for-sale and loans at fair value) included \$377.0 billion of credit exposure to 22 industry segments. Exposures related to SPEs and high-net-worth individuals were 34% and 14%, respectively, of this category. SPEs provide secured financing (generally backed by receivables, loans or bonds on a bankruptcy-remote, nonrecourse or limited-recourse basis) originated by a diverse group of companies in industries that are not highly correlated. For further discussion of SPEs, see Note 17 on pages 146–154 of this Annual Report. The remaining All other exposure is well-diversified across industries and none comprise more than 3% of total exposure.

## Derivative contracts

In the normal course of business, the Firm uses derivative instruments to meet the needs of customers; to generate revenue through trading activities; to manage exposure to fluctuations in interest rates, currencies and other markets; and to manage the Firm's credit exposure. For further discussion of these contracts, see Note 30 on pages 168–169 of this Annual Report.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

The following tables summarize the aggregate notional amounts and the net derivative receivables MTM for the periods presented.

### Notional amounts of derivative contracts

December 31, (in billions)	Notional amounts <sup>(a)</sup>	
	2007	2006
<b>Interest rate contracts</b>		
Interest rate and currency swaps <sup>(b)</sup>	\$ 53,458	\$ 40,629
Future and forwards	4,548	4,342
Purchased options	5,349	5,230
<b>Total interest rate contracts</b>	<b>63,355</b>	<b>50,201</b>
<b>Credit derivatives</b>	<b>\$ 7,967</b>	<b>\$ 4,619</b>
<b>Commodity contracts</b>		
Swaps	\$ 275	\$ 244
Future and forwards	91	68
Purchased options	233	195
<b>Total commodity contracts</b>	<b>599</b>	<b>507</b>
<b>Foreign exchange contracts</b>		
Future and forwards	\$ 3,424	\$ 1,824
Purchased options	906	696
<b>Total foreign exchange contracts</b>	<b>4,330</b>	<b>2,520</b>
<b>Equity contracts</b>		
Swaps	\$ 105	\$ 56
Future and forwards	72	73
Purchased options	821	680
<b>Total equity contracts</b>	<b>998</b>	<b>809</b>
<b>Total derivative notional amounts</b>	<b>\$ 77,249</b>	<b>\$ 58,656</b>

(a) Represents the sum of gross long and gross short third-party notional derivative contracts, excluding written options and foreign exchange spot contracts.

(b) Includes cross currency swap contract notional amounts of \$1.4 trillion and \$1.1 trillion at December 31, 2007 and 2006, respectively.

### Derivative receivables marked to market ("MTM")

December 31, (in millions)	Derivative receivables MTM	
	2007	2006
Interest rate contracts	\$ 36,020	\$ 28,932
Credit derivatives	22,083	5,732
Commodity contracts	9,419	10,431
Foreign exchange contracts	5,616	4,260
Equity contracts	3,998	6,246
<b>Total, net of cash collateral</b>	<b>77,136</b>	<b>55,601</b>
Liquid securities collateral held against derivative receivables	(9,824)	(6,591)
<b>Total, net of all collateral</b>	<b>\$ 67,312</b>	<b>\$ 49,010</b>

The amount of Derivative receivables reported on the Consolidated balance sheets of \$77.1 billion and \$55.6 billion at December 31, 2007 and 2006, respectively, is the amount of the mark-to-market value ("MTM") or fair value of the derivative contracts after giving effect to legally enforceable master netting agreements and cash collateral held by the Firm. These amounts represent the cost to the Firm to replace the contracts at current market rates should the counterparty default. However, in management's view, the appropriate measure of current credit risk should also reflect additional liquid securities held as collateral by the Firm of \$9.8 billion and \$6.6 billion at December 31, 2007 and 2006, respectively, resulting in total exposure, net of all collateral, of \$67.3 billion and \$49.0 billion at

December 31, 2007 and 2006, respectively. Derivative receivables increased \$18.3 billion from December 31, 2006, primarily driven by increases in credit derivative and interest rate products due to increased credit spreads and lower interest rates, respectively, as well as a decline in the U.S. dollar.

The Firm also holds additional collateral delivered by clients at the initiation of transactions, but this collateral does not reduce the credit risk of the derivative receivables in the table above. This additional collateral secures potential exposure that could arise in the derivatives portfolio should the MTM of the client's transactions move in the Firm's favor. As of December 31, 2007 and 2006, the Firm held \$17.4 billion and \$12.3 billion of this additional collateral, respectively. The derivative receivables MTM also does not include other credit enhancements in the form of letters of credit.

While useful as a current view of credit exposure, the net MTM value of the derivative receivables does not capture the potential future variability of that credit exposure. To capture the potential future variability of credit exposure, the Firm calculates, on a client-by-client basis, three measures of potential derivatives-related credit loss: Peak, Derivative Risk Equivalent ("DRE"), and Average exposure ("AVG"). These measures all incorporate netting and collateral benefits, where applicable.

Peak exposure to a counterparty is an extreme measure of exposure calculated at a 97.5% confidence level. However, the total potential future credit risk embedded in the Firm's derivatives portfolio is not the simple sum of all Peak client credit risks. This is because, at the portfolio level, credit risk is reduced by the fact that when offsetting transactions are done with separate counterparties, only one of the two trades can generate a credit loss, even if both counterparties were to default simultaneously. The Firm refers to this effect as market diversification, and the Market-Diversified Peak ("MDP") measure is a portfolio aggregation of counterparty Peak measures, representing the maximum losses at the 97.5% confidence level that would occur if all counterparties defaulted under any one given market scenario and time frame.

Derivative Risk Equivalent exposure is a measure that expresses the riskiness of derivative exposure on a basis intended to be equivalent to the riskiness of loan exposures. The measurement is done by equating the unexpected loss in a derivative counterparty exposure (which takes into consideration both the loss volatility and the credit rating of the counterparty) with the unexpected loss in a loan exposure (which takes into consideration only the credit rating of the counterparty). DRE is a less extreme measure of potential credit loss than Peak and is the primary measure used by the Firm for credit approval of derivative transactions.

Finally, AVG is a measure of the expected MTM value of the Firm's derivative receivables at future time periods, including the benefit of collateral. AVG exposure over the total life of the derivative contract is used as the primary metric for pricing purposes and is used to calculate credit capital and the Credit Valuation Adjustment ("CVA"), as further described below. Average exposure was \$47.1 billion and \$35.6 billion at December 31, 2007 and 2006, respectively, compared with derivative receivables MTM, net of all collateral, of \$67.3 billion and \$49.0 billion at December 31, 2007 and 2006, respectively.

The MTM value of the Firm's derivative receivables incorporates an adjustment, the CVA, to reflect the credit quality of counterparties. The CVA is based upon the Firm's AVG to a counterparty and the counterparty's credit spread in the credit derivatives market. The primary components of changes in CVA are credit spreads, new deal activity or unwinds, and changes in the underlying market environment. The Firm believes that active risk management is essential to controlling the dynamic credit risk in the derivatives portfolio. In addition, the Firm takes into consideration the potential for correlation between the Firm's AVG to a counterparty and the counterparty's credit quality within the credit approval process. The Firm risk manages exposure to changes in CVA by entering into credit derivative transactions, as well as interest rate, foreign exchange, equity and commodity derivative transactions.

The graph to the right shows exposure profiles to derivatives over the next 10 years as calculated by the MDP, DRE and AVG metrics. All three measures generally show declining exposure after the first year, if no new trades were added to the portfolio.

The following table summarizes the ratings profile of the Firm's derivative receivables MTM, net of other liquid securities collateral, for the dates indicated.

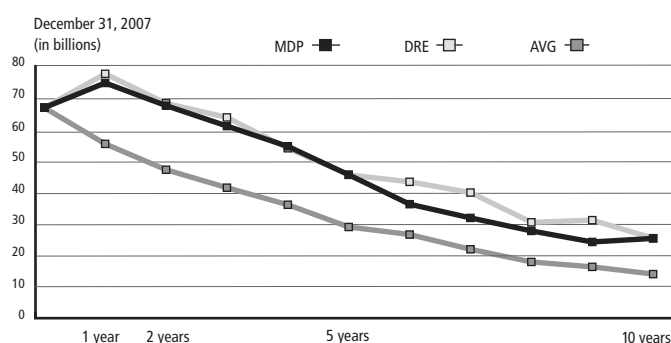
#### Ratings profile of derivative receivables MTM

Rating equivalent December 31, (in millions, except ratios)	2007		2006	
	Exposure net of all collateral	% of exposure net of all collateral	Exposure net of all collateral	% of exposure net of all collateral
AAA/Aaa to AA-/Aa3	\$ 38,314	57%	\$ 28,150	58%
A+/A1 to A-/A3	9,855	15	7,588	15
BBB+/Baa1 to BBB-/Baa3	9,335	14	8,044	16
BB+/Ba1 to B-/B3	9,451	14	5,150	11
CCC+/Caa1 and below	357	—	78	—
<b>Total</b>	<b>\$ 67,312</b>	<b>100%</b>	<b>\$ 49,010</b>	<b>100%</b>

The Firm actively pursues the use of collateral agreements to mitigate counterparty credit risk in derivatives. The percentage of the Firm's derivatives transactions subject to collateral agreements increased slightly to 82% as of December 31, 2007, from 80% at December 31, 2006.

The Firm posted \$33.5 billion and \$26.6 billion of collateral at December 31, 2007 and 2006, respectively. Certain derivative and collateral agreements include provisions that require the counterparty and/or the Firm, upon specified downgrades in their respective credit ratings, to post collateral for the benefit of the other party. The impact of a single-notch ratings downgrade to JPMorgan Chase Bank, N.A., from its rating of "AA" to "AA-" at December 31, 2007, would have required \$237 million of additional collateral to be posted by the Firm. The impact of a six-notch ratings downgrade (from "AA" to "BBB") would have required \$2.5 billion of additional collateral. Certain derivative contracts also provide for termination of the contract, generally upon a downgrade of either the Firm or the counterparty, at the then-existing MTM value of the derivative contracts.

#### Exposure profile of derivatives measures



#### Credit derivatives

The following table presents the Firm's notional amounts of credit derivatives protection purchased and sold as of December 31, 2007 and 2006.

December 31, (in billions)	Notional amount				Total
	Credit portfolio		Dealer/client		
	Protection purchased <sup>(a)</sup>	Protection sold	Protection purchased	Protection sold	
2007	\$ 70	\$ 2	\$ 3,999	\$ 3,896	\$ 7,967
2006	\$ 52	\$ 1	\$ 2,277	\$ 2,289	\$ 4,619

(a) Included \$31.1 billion and \$22.7 billion at December 31, 2007 and 2006, respectively, that represented the notional amount for structured portfolio protection; the Firm retains a minimal first risk of loss on this portfolio.

JPMorgan Chase has counterparty exposure as a result of credit derivatives transactions. Of the \$77.1 billion of total Derivative receivables MTM at December 31, 2007, \$22.1 billion, or 29%, was associated with credit derivatives, before the benefit of liquid securities collateral.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### Dealer/client business

At December 31, 2007, the total notional amount of protection purchased and sold in the dealer/client business increased \$3.3 trillion from year-end 2006 as a result of increased trade volume in the market. The risk positions are largely matched when securities used to risk-manage certain derivative positions are taken into consideration and the notional amounts are adjusted to a duration-based equivalent or to reflect different degrees of subordination in tranching structures.

### Credit portfolio activities

In managing its wholesale credit exposure, the Firm purchases single-name and portfolio credit derivatives; this activity does not reduce the reported level of assets on the balance sheet or the level of reported off-balance sheet commitments. The Firm also diversifies its exposures by providing (i.e., selling) credit protection, which increases exposure to industries or clients where the Firm has little or no client-related exposure. This activity is not material to the Firm's overall credit exposure.

#### Use of single-name and portfolio credit derivatives

December 31, (in millions)	Notional amount of protection purchased	
	2007	2006
Credit derivatives used to manage:		
Loans and lending-related commitments	\$ 63,645	\$ 40,755
Derivative receivables	6,462	11,229
<b>Total<sup>(a)</sup></b>	<b>\$ 70,107</b>	<b>\$ 51,984</b>

(a) Included \$31.1 billion and \$22.7 billion at December 31, 2007 and 2006, respectively, that represented the notional amount for structured portfolio protection; the Firm retains a minimal first risk of loss on this portfolio.

The credit derivatives used by JPMorgan Chase for credit portfolio management activities do not qualify for hedge accounting under SFAS 133, and therefore, effectiveness testing under SFAS 133 is not performed. These derivatives are reported at fair value, with gains and losses recognized in Principal transactions revenue. The MTM value incorporates both the cost of credit derivative premiums and changes in value due to movement in spreads and credit events; in contrast, the loans and lending-related commitments being risk managed are accounted for on an accrual basis. Loan interest and fees are generally recognized in Net interest income, and impairment is recognized in the Provision for credit losses. This asymmetry in accounting treatment between loans and lending-related commitments and the credit derivatives utilized in credit portfolio management activities causes earnings volatility that is not representative, in the Firm's view, of the true changes in value of the Firm's overall credit exposure. The MTM related to the Firm's credit derivatives used for managing credit exposure, as well as the MTM related to the CVA, which reflects the credit quality of derivatives counterparty exposure, are included in the table below. These results can vary from period to period due to market conditions that impact specific positions in the portfolio.

Year ended December 31, (in millions)	2007	2006	2005
Hedges of lending-related commitments <sup>(a)</sup>	\$ 350	\$ (246)	\$ 24
CVA and hedges of CVA <sup>(a)</sup>	(363)	133	84
<b>Net gains (losses)<sup>(b)</sup></b>	<b>\$ (13)</b>	<b>\$ (113)</b>	<b>\$ 108</b>

(a) These hedges do not qualify for hedge accounting under SFAS 133.

(b) Excludes gains of \$373 million, \$56 million and \$8 million for the years ended December 31, 2007, 2006 and 2005, respectively, of other Principal transactions revenue that was not associated with hedging activities. The amount for 2007 incorporates an adjustment to the valuation of the Firm's derivative liabilities as a result of the adoption of SFAS 157 on January 1, 2008.

The Firm also actively manages wholesale credit exposure mainly through IB and CB loan and commitment sales. During 2007, 2006 and 2005, these sales of \$4.9 billion, \$4.0 billion and \$4.9 billion of loans and commitments, respectively, resulted in losses of \$7 million in 2007 and gains of \$83 million and \$81 million in 2006 and 2005, respectively. These results include gains on sales of nonperforming loans, as discussed on page 76 of this Annual Report. These activities are not related to the Firm's securitization activities, which are undertaken for liquidity and balance sheet management purposes. For a further discussion of securitization activity, see Liquidity Risk Management and Note 16 on pages 70–73 and 139–145, respectively, of this Annual Report.

### Lending-related commitments

Wholesale lending-related commitments were \$446.7 billion at December 31, 2007, compared with \$391.4 billion at December 31, 2006. The increase reflected greater overall lending activity. In the Firm's view, the total contractual amount of these instruments is not representative of the Firm's actual credit risk exposure or funding requirements. In determining the amount of credit risk exposure the Firm has to wholesale lending-related commitments, which is used as the basis for allocating credit risk capital to these instruments, the Firm has established a "loan-equivalent" amount for each commitment; this amount represents the portion of the unused commitment or other contingent exposure that is expected, based upon average portfolio historical experience, to become outstanding in the event of a default by an obligor. The loan-equivalent amount of the Firm's lending-related commitments was \$238.7 billion and \$212.3 billion as of December 31, 2007 and 2006, respectively.

## Emerging markets country exposure

The Firm has a comprehensive internal process for measuring and managing exposures to emerging markets countries. There is no common definition of emerging markets but the Firm generally, though not exclusively, includes in its definition those countries whose sovereign debt ratings are equivalent to "A+" or lower. Exposures to a country include all credit-related lending, trading and investment activities, whether cross-border or locally funded. In addition to monitoring country exposures, the Firm uses stress tests to measure and manage the risk of extreme loss associated with sovereign crises.

The table below presents the Firm's exposure to the top five emerging markets countries. The selection of countries is based solely on the Firm's largest total exposures by country and not the Firm's view of any actual or potentially adverse credit conditions. Exposure is reported based on the country where the assets of the obligor, counterparty or guarantor are located. Exposure amounts are adjusted for collateral and for credit enhancements (e.g., guarantees and letters of credit) provided by third parties; outstandings supported by a guarantor outside the country or backed by collateral held outside the country are assigned to the country of the enhancement provider. In addition, the effect of credit derivative hedges and other short credit or equity trading positions are reflected in the table below. Total exposure includes exposure to both government and private sector entities in a country.

## Top 5 emerging markets country exposure

At December 31, 2007

(in billions)	Cross-border				Local <sup>(d)</sup>	Total exposure
	Lending <sup>(a)</sup>	Trading <sup>(b)</sup>	Other <sup>(c)</sup>	Total		
South Korea	\$ 3.2	\$ 2.6	\$ 0.7	\$ 6.5	\$ 3.4	\$ 9.9
Brazil	1.1	(0.7)	1.2	1.6	5.0	6.6
Russia	2.9	1.0	0.2	4.1	0.4	4.5
India	1.9	0.8	0.8	3.5	0.6	4.1
China	2.2	0.3	0.4	2.9	0.3	3.2

(a) Lending includes loans and accrued interest receivable, interest-bearing deposits with banks, acceptances, other monetary assets, issued letters of credit net of participations, and undrawn commitments to extend credit.

(b) Trading includes (1) issuer exposure on cross-border debt and equity instruments, held both in trading and investment accounts, adjusted for the impact of issuer hedges, including credit derivatives; and (2) counterparty exposure on derivative and foreign exchange contracts as well as security financing trades (resale agreements and securities borrowed).

(c) Other represents mainly local exposure funded cross-border.

(d) Local exposure is defined as exposure to a country denominated in local currency, booked and funded locally.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### CONSUMER CREDIT PORTFOLIO

JPMorgan Chase's consumer portfolio consists primarily of residential mortgages, home equity loans, credit cards, auto loans and leases, education loans and business banking loans, and reflects the benefit of diversification from both a product and a geographic perspective. The primary focus is serving the prime consumer credit market. RFS offers home equity lines of credit and mortgage loans with interest-only payment options to predominantly prime borrowers; there are no products in the real estate portfolios that result in negative amortization.

The domestic consumer credit environment in 2007 was negatively affected by the deterioration in valuations associated with residential real estate. For the first time in decades, average home prices declined on a national basis, with many specific real estate markets recording double-digit percentage declines in average home prices. The negative residential real estate environment has also had an effect on the performance of other consumer credit asset classes, including auto loans and credit card loans. Geographic areas that have seen the most material declines in home prices have exhibited higher delinquency and losses across the consumer credit product spectrum.

Significant actions have been taken to tighten credit underwriting and loan qualification standards, especially related to real estate lending. Maximum loan-to-value and debt-to-income ratios have been reduced, minimum required credit risk scores for loan qualification have been increased and collateral valuation methods have been tightened.

These actions have resulted in significant reductions in new loan originations of risk layered loans, and improved alignment of loan pricing with the embedded risk.

Account management and loan servicing policies and actions have also been enhanced. Delinquency management, loss mitigation, and asset disposition efforts have been increased, while collection intensity, exposure management, debt restructuring, and other similar practices have been strengthened to effectively manage loss exposure.

The following table presents managed consumer credit-related information for the dates indicated.

#### Consumer portfolio

As of or for the year ended December 31, (in millions, except ratios)	Credit exposure		Nonperforming assets <sup>(f)</sup>		Net charge-offs		Average annual net charge-off rate <sup>(g)</sup>	
	2007	2006	2007	2006	2007	2006	2007	2006
<b>Consumer loans – reported<sup>(a)</sup></b>								
Home equity	\$ 94,832	\$ 85,714	\$ 810	\$ 454	\$ 564	\$ 143	0.62%	0.18%
Mortgage	55,461	30,577	1,798	653	190	56	0.45	0.12
Auto loans and leases <sup>(b)</sup>	42,350	41,009	116	132	354	238	0.86	0.56
Credit card – reported <sup>(c)</sup>	84,352	85,881	7	9	3,116	2,488	3.90	3.37
All other loans	25,314	23,460	341	322	242	139	1.01	0.65
Loans held-for-sale	3,989	32,744	—	116	NA	NA	NA	NA
<b>Total consumer loans – reported</b>	<b>306,298</b>	<b>299,385</b>	<b>3,072</b>	<b>1,686</b>	<b>4,466</b>	<b>3,064</b>	<b>1.61</b>	<b>1.17</b>
Credit card – securitized <sup>(c)(d)</sup>	72,701	66,950	—	—	2,380	2,210	3.43	3.28
<b>Total consumer loans – managed<sup>(c)</sup></b>	<b>378,999</b>	<b>366,335</b>	<b>3,072</b>	<b>1,686</b>	<b>6,846</b>	<b>5,274</b>	<b>1.97</b>	<b>1.60</b>
Assets acquired in loan satisfactions	NA	NA	549	225	NA	NA	NA	NA
<b>Total consumer-related assets – managed</b>	<b>378,999</b>	<b>366,335</b>	<b>3,621</b>	<b>1,911</b>	<b>6,846</b>	<b>5,274</b>	<b>1.97</b>	<b>1.60</b>
Consumer lending-related commitments:								
Home equity <sup>(e)</sup>	74,191	69,559	NA	NA	NA	NA	NA	NA
Mortgage	7,410	6,618	NA	NA	NA	NA	NA	NA
Auto loans and leases	8,058	7,874	NA	NA	NA	NA	NA	NA
Credit card <sup>(e)</sup>	714,848	657,109	NA	NA	NA	NA	NA	NA
All other loans	11,429	6,375	NA	NA	NA	NA	NA	NA
<b>Total lending-related commitments</b>	<b>815,936</b>	<b>747,535</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>
<b>Total consumer credit portfolio</b>	<b>\$ 1,194,935</b>	<b>\$ 1,113,870</b>	<b>\$ 3,621</b>	<b>\$ 1,911</b>	<b>\$ 6,846</b>	<b>\$ 5,274</b>	<b>1.97%</b>	<b>1.60%</b>
Memo: Credit card – managed	\$ 157,053	\$ 152,831	\$ 7	\$ 9	\$ 5,496	\$ 4,698	3.68%	3.33%

(a) Includes RFS, CS and residential mortgage loans reported in the Corporate segment.

(b) Excludes operating lease-related assets of \$1.9 billion and \$1.6 billion for December 31, 2007 and 2006, respectively.

(c) Loans past-due 90 days and over and accruing include credit card receivables – reported of \$1.5 billion and \$1.3 billion for December 31, 2007 and 2006, respectively, and related credit card securitizations of \$1.1 billion and \$962 million for December 31, 2007 and 2006, respectively.

(d) Represents securitized credit card receivables. For a further discussion of credit card securitizations, see CS on pages 49–51 of this Annual Report.

(e) The credit card and home equity lending-related commitments represent the total available lines of credit for these products. The Firm has not experienced, and does not anticipate, that all available lines of credit will be utilized at the same time. The Firm can reduce or cancel these lines of credit by providing the borrower prior notice or, in some cases, without notice as permitted by law.

(f) Excludes nonperforming assets related to (1) loans eligible for repurchase as well as loans repurchased from GNMA pools that are insured by U.S. government agencies of \$1.5 billion for December 31, 2007 and \$1.2 billion for December 31, 2006, and (2) education loans that are 90 days past due and still accruing, which are insured by U.S. government agencies under the Federal Family Education Loan Program of \$279 million and \$219 million as of December 31, 2007 and 2006, respectively. These amounts for GNMA and education loans are excluded, as reimbursement is proceeding normally.

(g) Net charge-off rates exclude average loans held-for-sale of \$10.6 billion and \$16.1 billion for 2007 and 2006, respectively.

The Firm regularly evaluates market conditions and overall economic returns and makes an initial determination of whether new originations will be held-for-investment or sold within the foreseeable future. The Firm also periodically evaluates the expected economic returns of previously originated loans under prevailing market conditions to determine whether their designation as held-for-sale or held-for-investment continues to be appropriate. When the Firm determines that a change in this designation is appropriate, the loans are transferred to the appropriate classification. During the third and fourth quarters of 2007, in response to changes in market conditions, the Firm designated as held-for-investment all new originations of subprime mortgage loans, as well as subprime mortgage loans that were previously designated held-for-sale. In addition, all new prime mortgage originations that cannot be sold to U.S. government agencies and U.S. government-sponsored enterprises have been designated as held-for-investment. Prime mortgage loans originated with the intent to sell are accounted for at fair value under SFAS 159 and are classified as Trading assets in the Consolidated Balance Sheets.

The following discussion relates to the specific loan and lending-related categories within the consumer portfolio.

**Home equity:** Home equity loans at December 31, 2007, were \$94.8 billion, an increase of \$9.1 billion from year-end 2006. The change in the portfolio from December 31, 2006, reflected organic growth. The Provision for credit losses for the Home equity portfolio includes net increases of \$1.0 billion to the Allowance for loan losses for the year ended December 31, 2007, as risk layered loans, continued weak housing prices and slowing economic growth have resulted in a significant increase in nonperforming assets and estimated losses, especially with respect to recently originated high loan-to-value loans in specific geographic regions that have experienced significant declines in housing prices. The decline in housing prices and the second lien position for these types of loans results in minimal proceeds upon foreclosure, increasing the severity of losses. Although subprime Home equity loans do not represent a significant portion of the Home equity loan balance, the origination of subprime home equity loans was discontinued in the third quarter of 2007. In addition, loss mitigation activities continue to be intensified, underwriting standards have been tightened and pricing actions have been implemented to reflect elevated risks related to the home equity portfolio.

The following tables present the geographic distribution of consumer credit outstandings by product as of December 31, 2007 and 2006.

### Consumer loans by geographic region

December 31, 2007 (in billions)	Home equity	Mortgage	Auto	Card reported	All other loans	Total consumer loans—reported	Card securitized	Total consumer loans—managed
<b>Top 12 states</b>								
California	\$ 14.9	\$ 13.4	\$ 5.0	\$ 11.0	\$ 1.0	\$ 45.3	\$ 9.6	\$ 54.9
New York	14.4	8.0	3.6	6.6	4.2	36.8	5.6	42.4
Texas	6.1	2.0	3.7	5.8	3.5	21.1	5.4	26.5
Florida	5.3	6.4	1.6	4.7	0.5	18.5	4.2	22.7
Illinois	6.7	3.0	2.2	4.5	1.9	18.3	3.9	22.2
Ohio	4.9	1.0	2.9	3.3	2.6	14.7	3.1	17.8
New Jersey	4.4	2.2	1.7	3.3	0.5	12.1	3.1	15.2
Michigan	3.7	1.6	1.3	2.9	2.3	11.8	2.5	14.3
Arizona	5.7	1.5	1.8	1.7	1.8	12.5	1.4	13.9
Pennsylvania	1.6	0.9	1.7	3.2	0.5	7.9	2.9	10.8
Colorado	2.3	1.3	1.0	2.0	0.8	7.4	1.7	9.1
Indiana	2.4	0.6	1.2	1.8	1.1	7.1	1.5	8.6
All other	22.4	14.1	14.7	33.6	8.0	92.8	27.8	120.6
<b>Total</b>	<b>\$ 94.8</b>	<b>\$ 56.0</b>	<b>\$ 42.4</b>	<b>\$ 84.4</b>	<b>\$ 28.7</b>	<b>\$ 306.3</b>	<b>\$ 72.7</b>	<b>\$ 379.0</b>

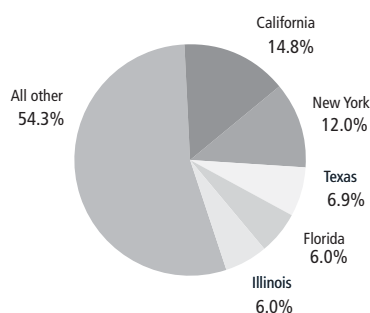
## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

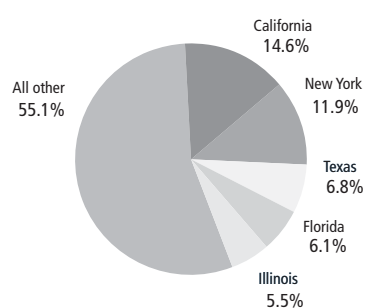
### Consumer loans by geographic region

December 31, 2006 (in billions)	Home equity	Mortgage	Auto	Card reported	All other loans	Total consumer loans—reported	Card securitized	Total consumer loans—managed
<b>Top 12 states</b>								
California	\$ 12.9	\$ 14.5	\$ 4.6	\$ 10.8	\$ 0.9	\$ 43.7	\$ 8.8	\$ 52.5
New York	12.2	8.9	3.2	7.0	4.2	35.5	5.0	40.5
Texas	5.8	2.1	3.2	6.0	3.3	20.4	5.1	25.5
Florida	4.4	7.1	1.6	4.8	0.5	18.4	3.7	22.1
Illinois	6.2	2.4	1.9	4.4	1.7	16.6	3.7	20.3
Ohio	5.3	1.0	2.5	3.4	2.5	14.7	2.9	17.6
New Jersey	3.5	2.6	1.9	3.4	0.4	11.8	2.7	14.5
Michigan	3.8	1.5	1.2	3.0	2.3	11.8	2.3	14.1
Arizona	5.4	1.5	1.6	1.6	1.4	11.5	1.2	12.7
Pennsylvania	1.5	1.1	1.6	3.4	0.4	8.0	2.6	10.6
Colorado	2.1	1.1	0.8	1.9	0.7	6.6	1.6	8.2
Indiana	2.6	0.5	1.0	1.8	1.1	7.0	1.4	8.4
All other	20.0	15.4	15.9	34.4	7.7	93.4	25.9	119.3
<b>Total</b>	<b>\$ 85.7</b>	<b>\$ 59.7</b>	<b>\$ 41.0</b>	<b>\$ 85.9</b>	<b>\$ 27.1</b>	<b>\$ 299.4</b>	<b>\$ 66.9</b>	<b>\$ 366.3</b>

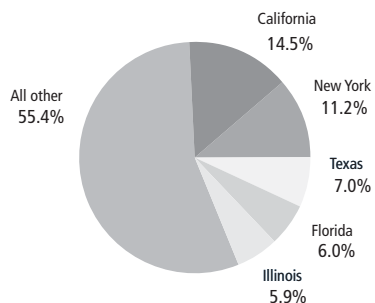
**Top 5 States Total Consumer Loans - Reported**  
(at December 31, 2007)



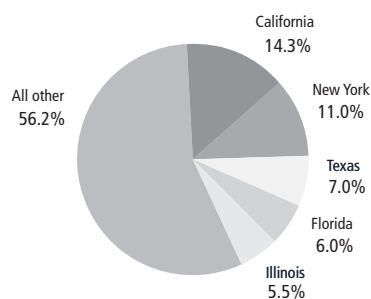
**Top 5 States Total Consumer Loans - Reported**  
(at December 31, 2006)



**Top 5 States Consumer Loans - Managed**  
(at December 31, 2007)



**Top 5 States Consumer Loans - Managed**  
(at December 31, 2006)



**Mortgage:** Prior to the third quarter of 2007, subprime mortgage loans and substantially all of the Firm's prime mortgages, both fixed-rate and adjustable-rate, were originated with the intent to sell. Prime mortgage loans originated into the held-for-investment portfolio consisted primarily of adjustable-rate products. As a result of the decision to retain rather than sell subprime mortgage loans and new originations of prime mortgage loans that cannot be sold to U.S. government agencies and U.S. government-sponsored enterprises, both fixed-rate and adjustable-rate products are now being originated into the held-for-investment portfolio. Mortgages, irrespective of whether they are originated with the intent to sell or hold-for-investment, are underwritten to the same standards applicable to the respective type of mortgage.

Mortgage loans at December 31, 2007, including loans held-for-sale, were \$56.0 billion, reflecting a \$3.6 billion decrease from year-end 2006, primarily due to the change in classification to Trading assets for prime mortgages originated with the intent to sell and elected to be fair valued under SFAS 159 offset partially by the decision to retain rather than sell subprime mortgage loans and new originations of prime mortgage loans that cannot be sold to U.S. government agencies and U.S. government-sponsored enterprises. As of December 31, 2007, mortgage loans on the Consolidated balance sheet included \$15.5 billion of subprime mortgage loans, representing 28% of the total mortgage loan balance. The Provision for credit losses for mortgage loans included \$166 million in increases to the allowance for loan losses for the year ended December 31, 2007, as housing price declines in specific geographic regions and slowing economic growth have resulted in increases in nonperforming assets and estimated losses for the subprime product segment. The Provision for credit losses also reflects the decision to retain rather than sell subprime mortgage loans. Loss mitigation activities have been intensified, products have been eliminated and underwriting standards continue to be tightened to reflect management's expectation of elevated credit losses in the subprime market segment. Nonperforming assets have also increased in the prime product segment. Borrowers are generally required to obtain private mortgage insurance for prime mortgage loans with high loan to value ratios. Recoveries on these insurance policies offset credit losses on these loans to the extent foreclosure proceeds are greater than 80% of the loan to value ratio at the time of origination. Additional housing price declines could result in an increase in the number of foreclosures for which proceeds are less than 80% of the original loan to value ratio, resulting in increased losses for this product segment.

**Auto loans and leases:** As of December 31, 2007, Auto loans and leases of \$42.4 billion increased slightly from year-end 2006. The Allowance for loan losses for the Auto loan portfolio was increased during 2007, reflecting an increase in estimated losses from low prior-year levels and deterioration in the credit environment.

#### **All other loans**

All other loans primarily include Business Banking loans (which are highly collateralized loans, often with personal loan guarantees), Education loans, Community Development loans and other secured and unsecured consumer loans. As of December 31, 2007, other loans, including loans held-for-sale, of \$28.7 billion were up \$1.6 billion from year-end 2006, primarily as a result of organic growth in Business Banking loans.

#### **Credit Card**

JPMorgan Chase analyzes its credit card portfolio on a managed basis, which includes credit card receivables on the Consolidated balance sheets and those receivables sold to investors through securitization. Managed credit card receivables were \$157.1 billion at December 31, 2007, an increase of \$4.2 billion from year-end 2006, reflecting organic growth in the portfolio.

The managed credit card net charge-off rate increased to 3.68% for 2007, from 3.33% in 2006. This increase was due primarily to lower bankruptcy-related net charge-offs in 2006. The 30-day delinquency rate increased slightly to 3.48% at December 31, 2007, from 3.13% at December 31, 2006. The Allowance for loan loss was increased due to higher estimated net charge-offs in the portfolio. The managed credit card portfolio continues to reflect a well-seasoned portfolio that has good U.S. geographic diversification.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### ALLOWANCE FOR CREDIT LOSSES

JPMorgan Chase's allowance for credit losses is intended to cover probable credit losses, including losses where the asset is not specifically identified or the size of the loss has not been fully determined. At least quarterly, the allowance for credit losses is reviewed by the Chief Risk Officer, the Chief Financial Officer and the Controller of the Firm, and discussed with the Risk Policy and Audit Committees of the Board of Directors of the Firm. The allowance is reviewed relative to the risk profile of the Firm's credit portfolio and current economic conditions and is adjusted if, in management's judgment, changes are warranted. The allowance includes an asset-specific and

a formula-based component. For further discussion of the components of the allowance for credit losses, see Critical accounting estimates used by the Firm on pages 96–97 and Note 15 on pages 138–139 of this Annual Report. At December 31, 2007, management deemed the allowance for credit losses to be appropriate (i.e., sufficient to absorb losses that are inherent in the portfolio, including losses that are not specifically identified or for which the size of the loss has not yet been fully determined).

#### Summary of changes in the allowance for credit losses

Year ended December 31, (in millions)	2007			2006		
	Wholesale	Consumer	Total	Wholesale	Consumer	Total
<b>Loans:</b>						
Beginning balance at January 1,	\$ 2,711	\$ 4,568	\$ 7,279	\$ 2,453	\$ 4,637	\$ 7,090
Cumulative effect of change in accounting principles <sup>(a)</sup>	(56)	—	(56)	—	—	—
Beginning balance at January 1, adjusted	2,655	4,568	7,223	2,453	4,637	7,090
Gross charge-offs	(185)	(5,182)	(5,367)	(186)	(3,698)	(3,884)
Gross recoveries	113	716	829	208	634	842
<b>Net (charge-offs) recoveries</b>	<b>(72)</b>	<b>(4,466)</b>	<b>(4,538)</b>	<b>22</b>	<b>(3,064)</b>	<b>(3,042)</b>
Provision for loan losses	598	5,940	6,538	213	2,940	3,153
Other	(27) <sup>(b)</sup>	38 <sup>(b)</sup>	11	23	55	78
<b>Ending balance at December 31</b>	<b>\$ 3,154<sup>(c)</sup></b>	<b>\$ 6,080<sup>(d)</sup></b>	<b>\$ 9,234</b>	<b>\$ 2,711<sup>(c)</sup></b>	<b>\$ 4,568<sup>(d)</sup></b>	<b>\$ 7,279</b>
<b>Components:</b>						
Asset-specific	\$ 108	\$ 80	\$ 188	\$ 51	\$ 67 <sup>(e)</sup>	\$ 118
Formula-based	3,046	6,000	9,046	2,660	4,501 <sup>(e)</sup>	7,161
<b>Total Allowance for loan losses</b>	<b>\$ 3,154</b>	<b>\$ 6,080</b>	<b>\$ 9,234</b>	<b>\$ 2,711</b>	<b>\$ 4,568</b>	<b>\$ 7,279</b>
<b>Lending-related commitments:</b>						
Beginning balance at January 1,	\$ 499	\$ 25	\$ 524	\$ 385	\$ 15	\$ 400
Provision for lending-related commitments	336	(10)	326	108	9	117
Other	—	—	—	6	1	7
<b>Ending balance at December 31</b>	<b>\$ 835</b>	<b>\$ 15</b>	<b>\$ 850</b>	<b>\$ 499</b>	<b>\$ 25</b>	<b>\$ 524</b>
<b>Components:</b>						
Asset-specific	\$ 28	\$ —	\$ 28	\$ 33	\$ —	\$ 33
Formula-based	807	15	822	466	25	491
<b>Total allowance for lending-related commitments</b>	<b>\$ 835</b>	<b>\$ 15</b>	<b>\$ 850</b>	<b>\$ 499</b>	<b>\$ 25</b>	<b>\$ 524</b>
<b>Total allowance for credit losses</b>	<b>\$ 3,989</b>	<b>\$ 6,095</b>	<b>\$ 10,084</b>	<b>\$ 3,210</b>	<b>\$ 4,593</b>	<b>\$ 7,803</b>

(a) Reflects the effect of the adoption of SFAS 159 at January 1, 2007. For a further discussion of SFAS 159, see Note 5 on pages 119–121 of this Annual Report.

(b) Partially related to the transfer of Allowance between wholesale and consumer in conjunction with prime mortgages transferred to the Corporate sector.

(c) The ratio of the wholesale Allowance for loan losses to total wholesale loans was 1.67% and 1.68%, excluding wholesale loans held-for-sale and loans accounted for at fair value at December 31, 2007 and 2006, respectively.

(d) The ratio of the consumer allowance for loan losses to total consumer loans was 2.01% and 1.71%, excluding consumer loans held-for-sale and loans accounted for at fair value at December 31, 2007 and 2006, respectively.

(e) Prior periods have been revised to reflect the current presentation.

The allowance for credit losses increased \$2.3 billion from December 31, 2006. The consumer and wholesale components of the allowance increased \$1.5 billion and \$779 million, respectively. The increase in the consumer portion of the allowance included increases of \$1.3 billion and \$215 million in RFS and CS, respectively. The increase in the wholesale portion of the allowance was primarily due to loan growth in the IB and CB.

Excluding Loans held-for-sale and loans carried at fair value, the Allowance for loan losses represented 1.88% of loans at December 31, 2007, compared with 1.70% at December 31, 2006.

To provide for the risk of loss inherent in the Firm's process of extending credit, management also computes an asset-specific component and a formula-based component for wholesale lending-related commitments. These components are computed using a methodology similar to that used for the wholesale loan portfolio, modified for expected maturities and probabilities of drawdown. This allowance, which is reported in Other liabilities, was \$850 million and \$524 million at December 31, 2007 and 2006, respectively. The increase reflected growth in lending-related commitments and updates to inputs used in the calculation.

## Provision for credit losses

For a discussion of the reported Provision for credit losses, see page 33 of this Annual Report. The managed provision for credit losses includes credit card securitizations. For the year ended December 31, 2007, the increase in the Provision for credit losses was due to an increase year-over-year in the allowance for credit losses largely related to home equity loans, higher credit card net charge-offs in the consumer businesses and an increase in the wholesale businesses. The increase in the allowance in the wholesale businesses was due to the weakening credit environment as well as growth in the wholesale portfolio. The prior year benefited from a lower level of credit card net charge-offs, which reflected a lower level of losses following the change in bankruptcy legislation in the fourth quarter of 2005.

Year ended December 31, (in millions)	Provision for loan losses			Provision for lending-related commitments			Total provision for credit losses		
	2007	2006	2005	2007	2006	2005	2007	2006	2005
Investment Bank	\$ 376	\$ 112	\$ (757)	\$ 278	\$ 79	\$ (81)	\$ 654	\$ 191	\$ (838)
Commercial Banking	230	133	87	49	27	(14)	279	160	73
Treasury & Securities Services	11	(1)	(1)	8	—	1	19	(1)	—
Asset Management	(19)	(30)	(55)	1	2	(1)	(18)	(28)	(56)
Corporate	—	(1)	10	—	—	—	—	(1)	10
<b>Total Wholesale</b>	<b>598</b>	<b>213</b>	<b>(716)</b>	<b>336</b>	<b>108</b>	<b>(95)</b>	<b>934</b>	<b>321</b>	<b>(811)</b>
Retail Financial Services	2,620	552	721	(10)	9	3	2,610	561	724
Card Services – reported	3,331	2,388	3,570	—	—	—	3,331	2,388	3,570
Corporate	(11)	—	—	—	—	—	(11)	—	—
<b>Total Consumer</b>	<b>5,940</b>	<b>2,940</b>	<b>4,291</b>	<b>(10)</b>	<b>9</b>	<b>3</b>	<b>5,930</b>	<b>2,949</b>	<b>4,294</b>
<b>Total provision for credit losses – reported</b>	<b>6,538</b>	<b>3,153</b>	<b>3,575</b>	<b>326</b>	<b>117</b>	<b>(92)</b>	<b>6,864</b>	<b>3,270</b>	<b>3,483</b>
Credit Services – securitized	2,380	2,210	3,776	—	—	—	2,380	2,210	3,776
<b>Total provision for credit losses – managed</b>	<b>\$8,918</b>	<b>\$5,363</b>	<b>\$7,351</b>	<b>\$ 326</b>	<b>\$117</b>	<b>\$ (92)</b>	<b>\$9,244</b>	<b>\$5,480</b>	<b>\$ 7,259</b>

### MARKET RISK MANAGEMENT

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Market risk is the exposure to an adverse change in the market value of portfolios and financial instruments caused by a change in market prices or rates.

#### Market risk management

Market risk is identified, measured, monitored, and controlled by Market Risk, a corporate risk governance function independent of the lines of business. Market Risk seeks to facilitate efficient risk/return decisions, reduce volatility in operating performance and make the Firm's market risk profile transparent to senior management, the Board of Directors and regulators. Market Risk is overseen by the Chief Risk Officer and performs the following functions:

- Establishment of a comprehensive market risk policy framework
- Independent measurement, monitoring and control of business segment market risk
- Definition, approval and monitoring of limits
- Performance of stress testing and qualitative risk assessments

#### Risk identification and classification

Market Risk works in partnership with the business segments to identify market risks throughout the Firm and to define and monitor market risk policies and procedures. All business segments are responsible for comprehensive identification and verification of market risks within their units. Risk-taking businesses have functions that act independently from trading personnel and are responsible for verifying risk exposures that the business takes. In addition to providing independent oversight for market risk arising from the business segments, Market Risk is also responsible for identifying exposures which may not be large within individual business segments, but which may be large for the Firm in aggregate. Regular meetings are held between Market Risk and the heads of risk-taking businesses to discuss and decide on risk exposures in the context of the market environment and client flows.

Positions that expose the Firm to market risk can be classified into two categories: trading and nontrading risk. Trading risk includes positions that are held by the Firm as part of a business segment or unit, the main business strategy of which is to trade or make markets. Unrealized gains and losses in these positions are generally reported in Principal transactions revenue. Nontrading risk includes securities and other assets held for longer-term investment, mortgage servicing rights, and securities and derivatives used to manage the Firm's asset/liability exposures. Unrealized gains and losses in these positions are generally not reported in Principal transactions revenue.

#### Trading risk

Fixed income risk (which includes interest rate risk and credit spread risk), foreign exchange, equities and commodities and other trading risks involve the potential decline in Net income or financial condition due to adverse changes in market rates, whether arising from client activities or proprietary positions taken by the Firm.

#### Nontrading risk

Nontrading risk arises from execution of the Firm's core business strategies, the delivery of products and services to its customers, and the discretionary positions the Firm undertakes to risk-manage exposures.

These exposures can result from a variety of factors, including differences in the timing among the maturity or repricing of assets, liabilities and off-balance sheet instruments. Changes in the level and shape of market interest rate curves also may create interest rate risk, since the repricing characteristics of the Firm's assets do not necessarily match those of its liabilities. The Firm is also exposed to basis risk, which is the difference in the repricing characteristics of two floating-rate indices, such as the prime rate and 3-month LIBOR. In addition, some of the Firm's products have embedded optionality that impact pricing and balances.

The Firm's mortgage banking activities give rise to complex interest rate risks, as well as option and basis risk. Option risk arises primarily from prepayment options embedded in mortgages and changes in the probability of newly originated mortgage commitments actually closing. Basis risk results from different relative movements between mortgage rates and other interest rates.

#### Risk measurement

##### Tools used to measure risk

Because no single measure can reflect all aspects of market risk, the Firm uses various metrics, both statistical and nonstatistical, including:

- Nonstatistical risk measures
- Value-at-risk ("VAR")
- Loss advisories
- Drawdowns
- Economic value stress testing
- Earnings-at-risk stress testing
- Risk identification for large exposures ("RIFLE")

## Nonstatistical risk measures

Nonstatistical risk measures other than stress testing include net open positions, basis point values, option sensitivities, market values, position concentrations and position turnover. These measures provide granular information on the Firm's market risk exposure. They are aggregated by line of business and by risk type, and are used for monitoring limits, one-off approvals and tactical control.

## Value-at-risk

JPMorgan Chase's primary statistical risk measure, VAR, estimates the potential loss from adverse market moves in an ordinary market environment and provides a consistent cross-business measure of risk profiles and levels of diversification. VAR is used for comparing risks across businesses, monitoring limits, one-off approvals, and as an input to economic capital calculations. VAR provides risk transparency in a normal trading environment. Each business day the Firm

undertakes a comprehensive VAR calculation that includes both its trading and its nontrading risks. VAR for nontrading risk measures the amount of potential change in the fair values of the exposures related to these risks; however, for such risks, VAR is not a measure of reported revenue since nontrading activities are generally not marked to market through Net income.

To calculate VAR, the Firm uses historical simulation, which measures risk across instruments and portfolios in a consistent and comparable way. This approach assumes that historical changes in market values are representative of future changes. The simulation is based upon data for the previous 12 months. The Firm calculates VAR using a one-day time horizon and an expected tail-loss methodology, which approximates a 99% confidence level. This means the Firm would expect to incur losses greater than that predicted by VAR estimates only once in every 100 trading days, or about two to three times a year.

## IB Trading and Credit Portfolio VAR

### IB trading VAR by risk type and credit portfolio VAR

As of or for the year ended December 31, (in millions)	2007			2006			At December 31,	
	Average VAR	Minimum VAR	Maximum VAR	Average VAR	Minimum VAR	Maximum VAR	2007	2006
<b>By risk type:</b>								
Fixed income	\$ 80	\$ 25	\$ 135	\$ 56	\$ 35	\$ 94	\$ 106	\$ 44
Foreign exchange	23	9	44	22	14	42	22	27
Equities	48	22	133	31	18	50	27	49
Commodities and other	33	21	66	45	22	128	27	41
Less: portfolio diversification	(77) <sup>(c)</sup>	NM <sup>(d)</sup>	NM <sup>(d)</sup>	(70) <sup>(c)</sup>	NM <sup>(d)</sup>	NM <sup>(d)</sup>	(82) <sup>(c)</sup>	(62) <sup>(c)</sup>
<b>Trading VAR<sup>(a)</sup></b>	<b>107</b>	<b>50</b>	<b>188</b>	<b>84</b>	<b>55</b>	<b>137</b>	<b>100</b>	<b>99</b>
Credit portfolio VAR <sup>(b)</sup>	17	8	31	15	12	19	22	15
Less: portfolio diversification	(18) <sup>(c)</sup>	NM <sup>(d)</sup>	NM <sup>(d)</sup>	(11) <sup>(c)</sup>	NM <sup>(d)</sup>	NM <sup>(d)</sup>	(19) <sup>(c)</sup>	(10) <sup>(c)</sup>
<b>Total trading and credit portfolio VAR</b>	<b>\$ 106</b>	<b>\$ 50</b>	<b>\$ 178</b>	<b>\$ 88</b>	<b>\$ 61</b>	<b>\$ 138</b>	<b>\$ 103</b>	<b>\$ 104</b>

(a) Trading VAR includes substantially all trading activities in IB; however, particular risk parameters of certain products are not fully captured, for example, correlation risk. Trading VAR does not include VAR related to held-for-sale funded loans and unfunded commitments, nor the DVA taken on derivative and structured liabilities to reflect the credit quality of the Firm. See the DVA Sensitivity table on page 92 of this Annual Report for further details. Trading VAR also does not include the MSR portfolio or VAR related to other corporate functions, such as Treasury and Private Equity. For a discussion of MSRs and the corporate functions, see Note 18 on pages 154–156, Note 4 on page 113 and Corporate on pages 59–60 of this Annual Report.

(b) Includes VAR on derivative credit valuation adjustments, hedges of the credit valuation adjustment and mark-to-market hedges of the retained loan portfolio, which are all reported in Principal transactions revenue. For a discussion of credit valuation adjustments, see Note 4 on pages 111–118 of this Annual Report. This VAR does not include the retained loan portfolio, which is not marked to market.

(c) Average and period-end VARs were less than the sum of the VARs of their market risk components, which was due to risk offsets resulting from portfolio diversification. The diversification effect reflected the fact that the risks were not perfectly correlated. The risk of a portfolio of positions is therefore usually less than the sum of the risks of the positions themselves.

(d) Designated as not meaningful ("NM") because the minimum and maximum may occur on different days for different risk components, and hence it is not meaningful to compute a portfolio diversification effect.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

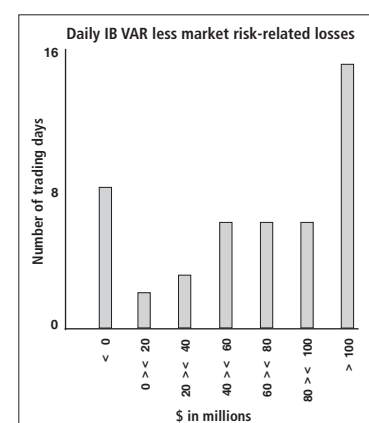
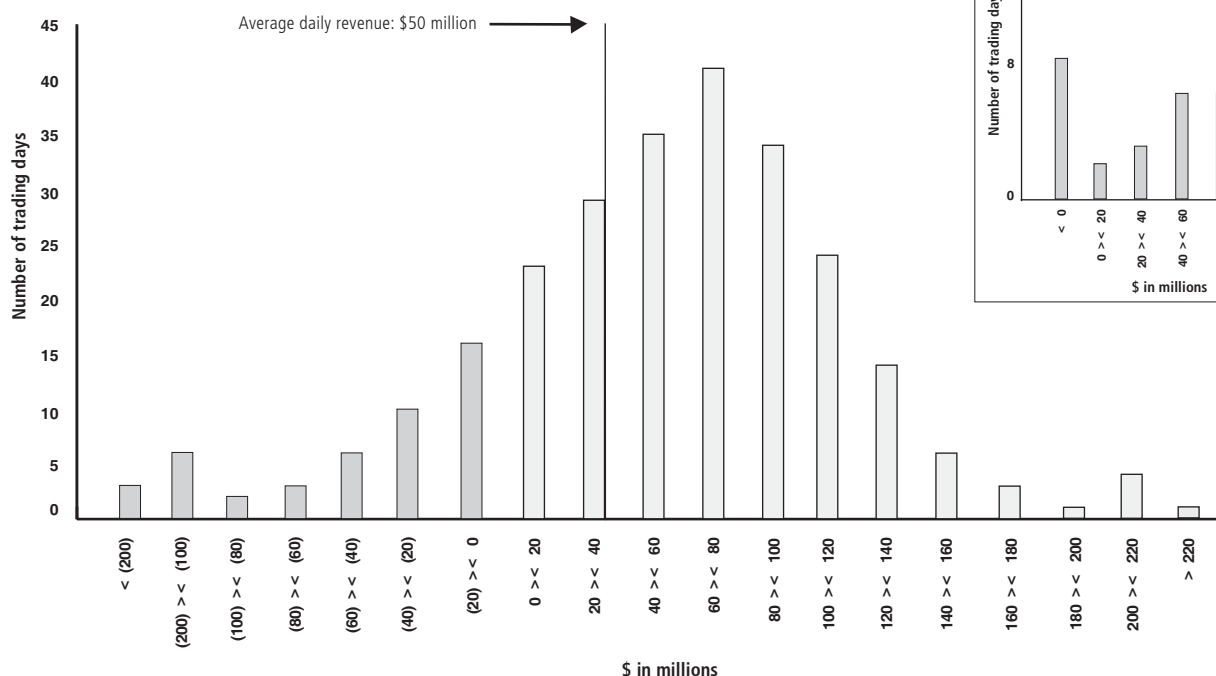
IB's average Total Trading and Credit Portfolio VAR was \$106 million for 2007, compared with \$88 million for 2006. Average VAR was higher during 2007 compared with the prior year, reflecting an increase in market volatility as well as increased risk positions, most notably in fixed income and equity markets. These changes also led to an increase in portfolio diversification, as Average Trading VAR diversification increased to \$77 million during 2007, from \$70 million during 2006. In general, over the course of the year, VAR exposures can vary significantly as positions change, market volatility fluctuates and diversification benefits change.

### VAR back-testing

To evaluate the soundness of its VAR model, the Firm conducts daily back-testing of VAR against daily IB market risk-related revenue, which is defined as the change in value of Principal transactions revenue less pri-

vate equity gains/losses plus any trading-related net interest income, brokerage commissions, underwriting fees or other revenue. The daily IB market risk-related revenue excludes gains and losses on held-for-sale funded loans and unfunded commitments and from debit valuation adjustments ("DVA"). The following histogram illustrates the daily market risk-related gains and losses for IB trading businesses for the year ended December 31, 2007. The chart shows that IB posted market risk-related gains on 215 out of 261 days in this period, with 53 days exceeding \$100 million. The inset graph looks at those days on which IB experienced losses and depicts the amount by which VAR exceeded the actual loss on each of those days. Losses were sustained on 46 days, with no loss greater than \$225 million. During 2007, losses exceeded the VAR measure on eight days due to the high market volatility experienced during the year. No losses exceeded VAR measure during 2006.

**Daily IB market risk-related gains and losses**  
Year ended December 31, 2007



The Firm does not include the impact of DVA taken on derivative and structured liabilities to reflect the credit quality of the Firm in its Trading VAR. The following table provides information about the sensitivity of DVA to a one basis point increase in JPMorgan Chase credit spreads.

### Debit Valuation Adjustment Sensitivity

(in millions)		1 Basis Point Increase in JPMorgan Chase Credit Spread
<b>December 31, 2007</b>		<b>\$ 38</b>

## Loss advisories and drawdowns

Loss advisories and drawdowns are tools used to highlight to senior management trading losses above certain levels and are used to initiate discussion of remedies.

## Economic value stress testing

While VAR reflects the risk of loss due to adverse changes in normal markets, stress testing captures the Firm's exposure to unlikely but plausible events in abnormal markets. The Firm conducts economic-value stress tests for both its trading and its nontrading activities at least once a month using multiple scenarios that assume credit spreads widen significantly, equity prices decline and interest rates rise in the major currencies. Additional scenarios focus on the risks predominant in individual business segments and include scenarios that focus on the potential for adverse moves in complex portfolios. Periodically, scenarios are reviewed and updated to reflect changes in the Firm's risk profile and economic events. Along with VAR, stress testing is important in measuring and controlling risk. Stress testing enhances the understanding of the Firm's risk profile and loss potential, and stress losses are monitored against limits. Stress testing is also utilized in one-off approvals and cross-business risk measurement, as well as an input to economic capital allocation. Stress-test results, trends and explanations are provided each month to the Firm's senior management and to the lines of business to help them better measure and manage risks and to understand event risk-sensitive positions.

## Earnings-at-risk stress testing

The VAR and stress-test measures described above illustrate the total economic sensitivity of the Firm's balance sheet to changes in market variables. The effect of interest rate exposure on reported Net income also is important. Interest rate risk exposure in the Firm's core nontrading business activities (i.e., asset/liability management positions) results from on- and off-balance sheet positions. The Firm conducts simulations of changes in NII from its nontrading activities under a variety of interest rate scenarios. Earnings-at-risk tests measure the potential change in the Firm's Net interest income over the next 12 months and highlight exposures to various rate-sensitive factors, such as the rates themselves (e.g., the prime lending rate), pricing strategies on deposits, optionality and changes in product mix. The tests include forecasted balance sheet changes, such as asset sales and securitizations, as well as prepayment and reinvestment behavior.

Earnings-at-risk also can result from changes in the slope of the yield curve, because the Firm has the ability to lend at fixed rates and borrow at variable or short-term fixed rates. Based upon these scenarios, the Firm's earnings would be affected negatively by a sudden and unanticipated increase in short-term rates without a corresponding increase in long-term rates. Conversely, higher long-term rates generally are beneficial to earnings, particularly when the increase is not accompanied by rising short-term rates.

Immediate changes in interest rates present a limited view of risk, and so a number of alternative scenarios also are reviewed. These scenarios include the implied forward curve, nonparallel rate shifts and severe interest rate shocks on selected key rates. These scenarios are intended to provide a comprehensive view of JPMorgan Chase's earnings-at-risk over a wide range of outcomes.

JPMorgan Chase's 12-month pretax earnings sensitivity profile as of December 31, 2007 and 2006, were as follows.

(in millions)	Immediate change in rates			
	+200bp	+100bp	-100bp	-200bp
<b>December 31, 2007</b>	<b>\$ (26)</b>	<b>\$ 55</b>	<b>\$(308)</b>	<b>\$ (664)</b>
December 31, 2006	\$ (101)	\$ 28	\$ (21)	\$ (182)

The primary change in earnings-at-risk from December 31, 2006, reflects increased prepayments on loans and securities due to lower market interest rates. The Firm is exposed to both rising and falling rates. The Firm's risk to rising rates is largely the result of increased funding costs. In contrast, the exposure to falling rates is the result of higher anticipated levels of loan and securities prepayments.

## Risk identification for large exposures ("RIFLE")

Individuals who manage risk positions, particularly those that are complex, are responsible for identifying potential losses that could arise from specific, unusual events, such as a potential tax change, and estimating the probabilities of losses arising from such events. This information is entered into the Firm's RIFLE database. Trading management has access to RIFLE, thereby permitting the Firm to monitor further earnings vulnerability not adequately covered by standard risk measures.

## Risk monitoring and control

### Limits

Market risk is controlled primarily through a series of limits. Limits reflect the Firm's risk appetite in the context of the market environment and business strategy. In setting limits, the Firm takes into consideration factors such as market volatility, product liquidity, business trends and management experience.

Market risk management regularly reviews and updates risk limits. Senior management, including the Firm's Chief Executive Officer and Chief Risk Officer, is responsible for reviewing and approving risk limits at least once a year.

The Firm maintains different levels of limits. Corporate-level limits include VAR and stress. Similarly, line-of-business limits include VAR and stress limits and may be supplemented by loss advisories, non-statistical measurements and instrument authorities. Businesses are responsible for adhering to established limits, against which exposures are monitored and reported. Limit breaches are reported in a timely manner to senior management, and the affected business segment is required either to reduce trading positions or consult with senior management on the appropriate action.

### Qualitative review

The Market Risk Management group also performs periodic reviews as necessary of both businesses and products with exposure to market risk in order to assess the ability of the businesses to control their market risk. Strategies, market conditions, product details and risk controls are reviewed, and specific recommendations for improvements are made to management.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JPMorgan Chase & Co.

### Model review

Some of the Firm's financial instruments cannot be valued based upon quoted market prices but are instead valued using pricing models. Such models are used for management of risk positions, such as reporting against limits, as well as for valuation. The Model Risk Group, independent of the businesses and market risk management, reviews the models the Firm uses and assesses model appropriateness and consistency. The model reviews consider a number of factors about the model's suitability for valuation and risk management of a particular product, including whether it accurately reflects the characteristics of the transaction and its significant risks, the suitability and convergence properties of numerical algorithms, reliability of data sources, consistency of the treatment with models for similar products, and sensitivity to input parameters and assumptions that cannot be priced from the market.

Reviews are conducted of new or changed models, as well as previously accepted models, to assess whether there have been any changes in the product or market that may impact the model's validity and whether there are theoretical or competitive developments that may require reassessment of the model's adequacy. For a summary of valuations based upon models, see Critical Accounting Estimates used by the Firm on pages 96–98 of this Annual Report.

### Risk reporting

Nonstatistical exposures, value-at-risk, loss advisories and limit excesses are reported daily for each trading and nontrading business. Market risk exposure trends, value-at-risk trends, profit and loss changes, and portfolio concentrations are reported weekly. Stress-test results are reported monthly to business and senior management.

## PRIVATE EQUITY RISK MANAGEMENT

### Risk management

The Firm makes direct principal investments in private equity. The illiquid nature and long-term holding period associated with these investments differentiates private equity risk from the risk of positions held in the trading portfolios. The Firm's approach to managing private equity risk is consistent with the Firm's general risk governance structure. Controls are in place establishing target levels for total and annual investment in order to control the overall size of the portfolio. Industry and geographic concentration limits are in place and intend-

ed to ensure diversification of the portfolio. An independent valuation function is responsible for reviewing the appropriateness of the carrying values of private equity investments in accordance with relevant accounting policies. At December 31, 2007 and 2006, the carrying value of the private equity businesses were \$7.2 billion and \$6.1 billion, respectively, of which \$390 million and \$587 million, respectively, represented publicly traded positions. For further information on the Private equity portfolio, see page 60 of this Annual Report.

## OPERATIONAL RISK MANAGEMENT

Operational risk is the risk of loss resulting from inadequate or failed processes or systems, human factors or external events.

### Overview

Operational risk is inherent in each of the Firm's businesses and support activities. Operational risk can manifest itself in various ways, including errors, fraudulent acts, business interruptions, inappropriate behavior of employees, or vendors that do not perform in accordance with outsourcing arrangements. These events could result in financial losses and other damage to the Firm, including reputational harm.

To monitor and control operational risk, the Firm maintains a system of comprehensive policies and a control framework designed to provide a sound and well-controlled operational environment. The goal is to keep operational risk at appropriate levels, in light of the Firm's financial strength, the characteristics of its businesses, the markets in which it operates, and the competitive and regulatory environment to which it is subject. Notwithstanding these control measures, the Firm incurs operational losses.

The Firm's approach to operational risk management is intended to mitigate such losses by supplementing traditional control-based approaches to operational risk with risk measures, tools and disciplines that are risk-specific, consistently applied and utilized firmwide. Key themes are transparency of information, escalation of key issues and accountability for issue resolution.

The Firm's operational risk framework is supported by Phoenix, an internally designed operational risk software tool. Phoenix integrates the individual components of the operational risk management framework into a unified, web-based tool. Phoenix enhances the capture, reporting and analysis of operational risk data by enabling risk identification, measurement, monitoring, reporting and analysis to be done in an integrated manner, thereby enabling efficiencies in the Firm's monitoring and management of its operational risk.

For purposes of identification, monitoring, reporting and analysis, the Firm categorizes operational risk events as follows:

- Client service and selection
- Business practices
- Fraud, theft and malice
- Execution, delivery and process management
- Employee disputes
- Disasters and public safety
- Technology and infrastructure failures