SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended August 31, 1998

OR

☐

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 1-11758

Morgan Stanley Dean Witter & Co.
(Exact Name of Registrant as Specified in its Charter)

Delaware **(State of Incorporation)**	**36-3145972** **(I.R.S. Employer Identification No.)**
1585 Broadway **New York, NY** **(Address of Principal Executive Offices)**	**10036** **(Zip Code)**

Registrant's telephone number, including area code: (212) 761-4000

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

As of September 30, 1998 there were 577,665,449 shares of Registrant's Common Stock, par value $.01 per share, outstanding.

MORGAN STANLEY DEAN WITTER & CO.

INDEX TO QUARTERLY REPORT ON FORM 10-Q

Quarter Ended August 31, 1998

MORGAN STANLEY DEAN WITTER & CO.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in millions, except share data)

	August 31, 1998 (unaudited)	November 30, 1997
ASSETS		
Cash and cash equivalents	$ 9,820	$ 8,255
Cash and securities deposited with clearing organizations or segregated under federal and other regulations (including securities at fair value of $6,383 at August 31, 1998 and $4,655 at November 30, 1997)	10,192	6,890
Financial instruments owned:		
U.S. government and agency securities	14,760	12,901
Other sovereign government obligations	20,636	22,900
Corporate and other debt	29,280	24,499
Corporate equities	10,903	10,329
Derivative contracts	22,511	17,146
Physical commodities	238	242
Securities purchased under agreements to resell	89,466	84,516
Receivable for securities provided as collateral(2)	13,975	—
Securities borrowed	82,359	55,266
Receivables:		
Consumer loans (net of allowances of $855 at August 31, 1998 and $884 at November 30, 1997)	16,802	20,033
Customers, net	19,992	12,259
Brokers, dealers and clearing organizations	5,585	13,263
Fees, interest and other	5,090	4,705
Office facilities, at cost (less accumulated depreciation and amortization of $1,405 at August 31, 1998 and $1,279 at November 30, 1997)	1,779	1,705
Other assets	7,541	7,378
Total assets	$ 360,929	$ 302,287
LIABILITIES AND SHAREHOLDERS' EQUITY		
Commercial paper and other short-term borrowings	$ 22,870	$ 22,614
Deposits .	8,718	8,993
Financial instruments sold, not yet purchased:		
U.S. government and agency securities	12,804	11,563
Other sovereign government obligations	12,349	12,095
Corporate and other debt	3,016	1,699
Corporate equities	11,593	13,305
Derivative contracts	20,790	15,599
Physical commodities	358	68
Securities sold under agreements to repurchase	118,148	111,680
Obligation to return securities received as collateral(2)	8,868	—
Securities loaned	30,115	14,141
Payables:		
Customers	52,938	25,086
Brokers, dealers and clearing organizations	5,208	16,097
Interest and dividends	687	970
Other liabilities and accrued expenses	9,356	8,630
Long-term borrowings	28,070	24,792
	345,888	287,332
Capital Units	999	999
Preferred Securities Issued by Subsidiaries	400	—
Commitments and contingencies		
Shareholders' equity:		
Preferred stock	674	876
Common stock(1) ($0.01 par value, 1,750,000,000 shares authorized, 605,842,952 and 602,829,994 shares issued, 582,790,622 and 594,708,971 shares outstanding at August 31, 1998 and at November 30, 1997)	6	6
Paid-in capital(1)	3,741	3,952
Retained earnings	11,120	9,330
Employee stock trust	1,601	1,337
Cumulative translation adjustments	(10)	(9)
Subtotal	17,132	15,492
Note receivable related to sale of preferred stock to ESOP	(68)	(68)
Common stock held in treasury, at cost(1) ($0.01 par value, 23,052,330 and 8,121,023 shares at August 31, 1998 and at November 30, 1997)	(1,821)	(250)
Stock compensation related adjustments	—	119
Common stock issued to employee trust	(1,601)	(1,337)
Total shareholders' equity	13,642	13,956
Total liabilities and shareholders' equity	$ 360,929	$302,287

(1) Historical amounts have been restated to reflect the Company's two-for-one stock split.
(2) These amounts relate to the Company's adoption of SFAS No. 127.

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY DEAN WITTER & CO.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(dollars in millions, except share and per share data)

	Three Months Ended August 31, 1998	Three Months Ended August 31, 1997	Nine Months Ended August 31, 1998	Nine Months Ended August 31, 1997
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 819	$ 818	$ 2,607	$ 1,921
Principal transactions:				
Trading	499	778	2,493	2,369
Investments	(174)	206	(1)	398
Commissions	608	559	1,766	1,533
Fees:				
Asset management, distribution and administration	718	656	2,135	1,853
Merchant and cardmember	438	433	1,270	1,293
Servicing	255	196	658	582
Interest and dividends	4,283	3,570	12,429	10,136
Other	52	41	154	108
Total revenues	7,498	7,257	23,511	20,193
Interest expense	3,377	2,765	10,076	7,952
Provision for consumer loan losses	280	385	960	1,140
Net revenues	3,841	4,107	12,475	11,101
Non-interest expenses:				
Compensation and benefits	1,609	1,849	5,414	4,844
Occupancy and equipment	148	134	431	389
Brokerage, clearing and exchange fees	126	130	377	338
Information processing and communications	291	249	833	786
Marketing and business development	354	293	934	855
Professional services	176	127	460	319
Other	193	219	549	579
Merger related costs	—	—	—	74
Total non-interest expenses	2,897	3,001	8,998	8,184
Income before income taxes	944	1,106	3,477	2,917
Provision for income taxes	299	428	1,287	1,141
Net income	$ 645	$ 678	$ 2,190	$ 1,776
Preferred stock dividend requirements	$ 14	$ 15	$ 43	$ 52
Earnings applicable to common shares(1)	$ 631	$ 663	$ 2,147	$ 1,724
Earnings per common share(2)				
Basic	$ 1.10	$ 1.15	$ 3.69	$ 3.00
Diluted	$ 1.05	$ 1.09	$ 3.51	$ 2.85
Average common shares outstanding(2)				
Basic	573,170,507	578,082,806	582,105,755	574,048,186
Diluted	604,779,594	610,019,122	613,265,207	605,565,186

(1) Amounts shown are used to calculate basic earnings per common share.
(2) Historical share and per share amounts have been restated to reflect the Company's two-for-one stock split.

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY DEAN WITTER & CO.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in millions)

	Nine Months Ended August 31, 1998 (unaudited)	Nine Months Ended August 31, 1997 (unaudited)
Cash flows from operating activities		
Net income	$ 2,190	$ 1,776
Adjustments to reconcile net income to net cash (used for) provided by operating activities:		
Non-cash charges included in net income	1,382	1,252
Changes in assets and liabilities:		
Cash and securities deposited with clearing organizations or segregated under federal and other regulations	(3,302)	1,717
Financial instruments owned, net of financial instruments sold, not yet purchased	(8,974)	4,676
Securities borrowed, net of securities loaned	(11,119)	(8,907)
Receivables and other assets	(1,008)	(2,497)
Payables and other liabilities	17,419	6,002
Net cash (used for) provided by operating activities	(3,412)	4,019
Cash flows from investing activities		
Net (payments for) proceeds from:		
Office facilities	(283)	(92)
Net principal disbursed on consumer loans	(1,130)	(3,248)
Sales of consumer loans	3,416	787
Other investing activities	—	(96)
Net cash provided by (used for) investing activities	2,003	(2,649)
Cash flows from financing activities		
Net proceeds (payments) related to short-term borrowings	169	(1,232)
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell	1,518	(200)
Deposits	(275)	1,631
Proceeds from:		
Issuance of common stock	175	108
Issuance of long-term borrowings	9,245	6,375
Issuance of Capital Units	—	134
Preferred Securities Issued by Subsidiaries	400	—
Payments for:		
Repurchases of common stock	(2,049)	(124)
Repayments of long-term borrowings	(5,614)	(3,398)
Redemption of cumulative preferred stock	(200)	(345)
Cash dividends	(395)	(319)
Net cash provided by financing activities	2,974	2,630
Elimination of Dean Witter, Discover & Co.'s net cash activity for the month of December 1996	—	(1,158)
Net increase in cash and cash equivalents	1,565	2,842
Cash and cash equivalents, at beginning of period	8,255	6,544
Cash and cash equivalents, at end of period	$ 9,820	$ 9,386

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY DEAN WITTER & CO.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Introduction and Basis of Presentation

The Merger

On May 31, 1997, Morgan Stanley Group Inc. (“Morgan Stanley”) was merged with and into Dean Witter, Discover & Co. (“Dean Witter Discover”) (the “Merger”). At that time, Dean Witter Discover changed its corporate name to Morgan Stanley, Dean Witter, Discover & Co. (“MSDWD”). In conjunction with the Merger, MSDWD issued 260,861,078 shares of its common stock, as each share of Morgan Stanley common stock then outstanding was converted into 1.65 shares of MSDWD’s common stock (the “Exchange Ratio”). In addition, each share of Morgan Stanley preferred stock was converted into one share of a corresponding series of preferred stock of MSDWD. The Merger was treated as a tax-free exchange.

On March 24, 1998, MSDWD changed its corporate name to Morgan Stanley Dean Witter & Co. (the “Company”).

The Company

The condensed consolidated financial statements include the accounts of Morgan Stanley Dean Witter & Co. and its U.S. and international subsidiaries, including Morgan Stanley & Co. Incorporated (“MS&Co.”), Morgan Stanley & Co. International Limited (“MSIL”), Morgan Stanley Japan Limited (“MSJL”), Dean Witter Reynolds Inc. (“DWR”), Morgan Stanley Dean Witter Advisors Inc. and NOVUS Credit Services Inc.

The Company, through its subsidiaries, provides a wide range of financial and securities services on a global basis and provides credit and transaction services nationally. Its securities and asset management businesses include securities underwriting, distribution and trading; merger, acquisition, restructuring, real estate, project finance and other corporate finance advisory activities; asset management; private equity and other principal investment activities; brokerage and research services; the trading of foreign exchange and commodities as well as derivatives on a broad range of asset categories, rates and indices; and global custody, securities clearance services and securities lending. The Company’s credit and transaction services businesses include the operation of the NOVUS Network, a proprietary network of merchant and cash access locations, and the issuance of the Discover® Card and other proprietary general purpose credit cards. The Company’s services are provided to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

Basis of Financial Information and Change in Fiscal Year End

The condensed consolidated financial statements give retroactive effect to the Merger, which was accounted for as a pooling of interests. The pooling of interests method of accounting requires the restatement of all periods presented as if Dean Witter Discover and Morgan Stanley had always been combined.

Prior to the Merger, Dean Witter Discover’s year ended on December 31 and Morgan Stanley’s fiscal year ended on November 30. Subsequent to the Merger, the Company adopted a fiscal year end of November 30. All information included herein reflects the change in fiscal year end.

The condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles, which require management to make estimates and assumptions regarding certain trading inventory valuations, consumer loan loss levels, the potential outcome of litigation and other matters that affect the financial statements and related disclosures. Management believes that the estimates utilized in the preparation of the condensed consolidated financial statements are prudent and reasonable. Actual results could differ materially from these estimates.

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

The condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K (the "Form 10-K") for the fiscal year ended November 30, 1997. The condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for the fair statement of the results for the interim period. The results of operations for interim periods are not necessarily indicative of results for the entire year.

Financial instruments, including derivatives, used in the Company's trading activities are recorded at fair value, and unrealized gains and losses are reflected in trading revenues. Interest revenue and expense arising from financial instruments used in trading activities are reflected in the condensed consolidated statements of income as interest revenue or expense. The fair values of trading positions generally are based on listed market prices. If listed market prices are not available or if liquidating the Company's positions would reasonably be expected to impact market prices, fair value is determined based on other relevant factors, including dealer price quotations and price quotations for similar instruments traded in different markets, including markets located in different geographic areas. Fair values for certain derivative contracts are derived from pricing models which consider current market and contractual prices for the underlying financial instruments or commodities, as well as time value and yield curve or volatility factors underlying the positions. Purchases and sales of financial instruments are recorded in the accounts on trade date. Unrealized gains and losses arising from the Company's dealings in over-the-counter ("OTC") financial instruments, including derivative contracts related to financial instruments and commodities, are presented in the accompanying condensed consolidated statements of financial condition on a net-by-counterparty basis, when appropriate.

Equity securities purchased in connection with private equity and other principal investment activities are initially carried in the condensed consolidated financial statements at their original costs. The carrying value of such equity securities is adjusted when changes in the underlying fair values are readily ascertainable, generally as evidenced by listed market prices or transactions which directly affect the value of such equity securities. Downward adjustments relating to such equity securities are made in the event that the Company determines that the eventual realizable value is less than the carrying value. The carrying value of investments made in connection with principal real estate activities which do not involve equity securities are adjusted periodically based on independent appraisals, estimates prepared by the Company of discounted future cash flows of the underlying real estate assets or other indicators of fair value.

Loans made in connection with private equity and investment banking activities are carried at cost plus accrued interest less reserves, if deemed necessary, for estimated losses.

The Company has entered into various contracts as hedges against specific assets, liabilities or anticipated transactions. These contracts include interest rate swaps, foreign exchange forwards, foreign currency swaps, and cost of funds agreements. The Company uses interest rate and currency swaps to manage the interest rate and currency exposure arising from certain borrowings and to match the refinancing characteristics of consumer loans with the borrowings that fund these loans. For contracts that are designated as hedges of the Company's assets and liabilities, gains and losses are deferred and recognized as adjustments to interest revenue or expense over the remaining life of the underlying assets or liabilities. For contracts that are hedges of asset securitizations, gains and losses are recognized as adjustments to servicing fees. Gains and losses resulting from the termination of hedge contracts prior to their stated maturity are recognized ratably over the remaining life of the instrument being hedged. The Company also uses foreign exchange forward contracts to manage the currency exposure relating to its net monetary investment in non-U.S. dollar functional currency operations. The gain or loss from revaluing these contracts is deferred and reported within cumulative translation adjustments in shareholders' equity, net of tax effects, with the related unrealized amounts due from or to counterparties included in receivables from or payables to brokers, dealers and clearing organizations.

Earnings Per Share

As of December 1, 1997, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share" ("SFAS No. 128"). SFAS No. 128 replaces the previous earnings per share ("EPS") categories of primary and fully diluted with "basic EPS," which reflects no dilution from common stock equivalents, and "diluted EPS," which reflects dilution from common stock equivalents and other dilutive securities based on the average price per share of the Company's common stock during the period. The EPS amounts of prior periods have been restated in accordance with SFAS No. 128. The adoption of SFAS No. 128 has not had a material effect on the Company's EPS calculations.

The calculations of earnings per common share are based on the weighted average number of common shares and share equivalents outstanding and give effect to preferred stock dividend requirements. All per share and share amounts reflect stock splits effected by Dean Witter Discover and Morgan Stanley prior to the Merger, as well as the additional shares issued to Morgan Stanley shareholders pursuant to the Exchange Ratio.

Accounting Pronouncements

In July 1998, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue 97-14, "Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested" ("EITF 97-14"). Under EITF 97-14, assets of the rabbi trust are to be consolidated with those of the employer, and the value of the employer's stock held in the rabbi trust should be classified in shareholders' equity and accounted for in a manner similar to treasury stock. The Company has therefore included the assets of its rabbi trusts, consisting solely of shares of the Company's common stock issued under certain deferred compensation plans, in employee stock trust with a corresponding amount in common stock issued to employee trust, both components of shareholders' equity. The adoption of EITF 97-14 did not result in any change to the Company's condensed consolidated statement of income, total assets, total liabilities or total shareholders' equity.

In September 1998, the FASB staff addressed the accounting for expenditures incurred by the investment advisors of closed-end funds. The FASB staff concluded that such costs are to be considered start-up costs in accordance with AICPA Statement of Position 98-5, "Reporting on the Costs of Start-Up Activities" ("SOP 98-5"). Accordingly, offering costs incurred by an investment advisor in connection with the distribution of shares of a closed-end fund should be expensed as incurred. As a result, the Company will be required to expense its deferred advisory fees and record a cumulative effect charge as of the beginning of the period during which it adopts the provisions of SOP 98-5, which must be no later than fiscal 2000. The Company is in the process of evaluating the cumulative effect of adopting SOP 98-5.

As of January 1, 1998, the Company adopted SFAS No. 127, "Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125," which was effective for transfers and pledges of certain financial assets and collateral made after December 31, 1997. The adoption of SFAS No. 127 created additional assets and liabilities on the Company's condensed consolidated statement of financial condition related to the recognition of securities provided and received as collateral. At August 31, 1998, the impact of SFAS No. 127 on the Company's condensed consolidated statement of financial condition (excluding reclassifications) was an increase to total assets and total liabilities of $3,477 million.

In June 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 130, "Reporting Comprehensive Income" and SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." These statements, which are effective for fiscal years beginning after December 15, 1997, establish standards for the reporting and presentation of comprehensive income and the disclosure requirements related to segments.

In February 1998, the FASB issued SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," which revises and standardizes pension and other postretirement benefit plan disclosures that are to be included in the employers' financial statements. SFAS No. 132 does not change the measurement or recognition rules for pensions and other postretirement benefit plans, and is effective for fiscal years beginning after December 15, 1997.

In June 1998, the FASB issued SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities”, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The statement is effective for fiscal years beginning after June 15, 1999. The Company is in the process of evaluating the impact of adopting SFAS No. 133.

2. Consumer Loans

Activity in the allowance for consumer loan losses was as follows (dollars in millions):

	Three Months Ended August 31,		Nine Months Ended August 31,	
	1998	1997	1998	1997
Balance, beginning of period	$824	$821	$ 884	$ 781
Provision for loan losses	280	385	960	1,140
Less deductions				
Charge-offs	318	401	1,112	1,218
Recoveries	(40)	(44)	(139)	(126)
Net charge-offs	278	357	973	1,092
Other(1)	29	19	(16)	39
Balance, end of period	$855	$868	$ 855	$ 868

(1) Primarily reflects transfers related to asset securitizations and the fiscal 1998 sale of the Company’s Prime Option MasterCard portfolio.

Interest accrued on loans subsequently charged off, recorded as a reduction of interest revenue, was $42 million and $157 million in the quarter and nine month period ended August 31, 1998 and $70 million and $230 million in the quarter and nine months ended August 31, 1997. Due to enhancements made to certain of the Company’s operating systems, the amounts charged off in fiscal 1998 include only interest, whereas the prior year also included cardmember fees.

The Company received net proceeds from asset securitizations of $1,213 million and $3,416 million in the quarter and nine month period ended August 31, 1998. The uncollected balances of consumer loans sold through asset securitizations were $16,571 million at August 31, 1998 and $15,033 million at November 30, 1997.

3. Long-Term Borrowings

Long-term borrowings at August 31, 1998 scheduled to mature within one year aggregated $6,246 million.

During the nine month period ended August 31, 1998, the Company issued senior notes aggregating $9,301 million, including non-U.S. dollar currency notes aggregating $1,532 million, primarily pursuant to its public debt shelf registration statements. The weighted average coupon interest rate of these notes was 5.84% at August 31, 1998; the Company has entered into certain transactions to obtain floating interest rates based primarily on short-term LIBOR trading levels. Maturities in the aggregate of these notes by fiscal year are as follows: 1998, $35 million; 1999, $1,222 million; 2000, $2,810 million; 2001, $1,657 million; 2002, $6 million; 2003, $1,286 million; and thereafter $2,285. In the nine month period ended August 31, 1998, $5,614 million of senior notes were repaid.

4. Preferred Stock, Capital Units and Preferred Securities Issued by Subsidiaries

Preferred stock is composed of the following issues:

	Shares Outstanding at		Balance at	
	August 31, 1998	November 30, 1997	August 31, 1998	November 30, 1997
			(dollars in millions)	
ESOP Convertible Preferred Stock, liquidation preference $35.88	3,596,408	3,646,664	$129	$131
Series A Fixed/Adjustable Rate Cumulative Preferred Stock, stated value $200	1,725,000	1,725,000	345	345
7-3/4% Cumulative Preferred Stock, stated value $200	1,000,000	1,000,000	200	200
7-3/8% Cumulative Preferred Stock, stated value $200	—	1,000,000	—	200
Total			$674	$876

Each issue of outstanding preferred stock ranks in parity with all other outstanding preferred stock of the Company.

The Company has Capital Units outstanding which were issued by the Company and Morgan Stanley Finance plc (“MS plc”), a U.K. subsidiary. A Capital Unit consists of (a) a Subordinated Debenture of MS plc guaranteed by the Company and having maturities from 2013 to 2017 and (b) a related Purchase Contract issued by the Company, which may be accelerated by the Company beginning approximately one year after the issuance of each Capital Unit, requiring the holder to purchase one Depositary Share representing shares (or fractional shares) of the Company’s Cumulative Preferred Stock. The aggregate amount of Capital Units outstanding was $999 million at August 31, 1998 and November 30, 1997.

On March 5, 1998, MSDW Capital Trust I, a Delaware statutory business trust (the “Capital Trust”), all of the common securities of which are owned by the Company, issued $400 million of 7.10% Capital Securities (the “Capital Securities”) that are guaranteed by the Company. The Capital Trust issued the Capital Securities and invested the proceeds in 7.10% Junior Subordinated Deferrable Interest Debentures issued by the Company, which are due February 28, 2038.

On August 31, 1998, the Company redeemed all 1,000,000 outstanding shares of its 7-3/8% Cumulative Preferred Stock at a redemption price of $200 per share. The Company also simultaneously redeemed all corresponding Depositary Shares at a redemption price of $25 per Depositary Share. Each Depositary Share represented 1/8 of a share of the Company’s 7-3/8% Cumulative Preferred Stock.

5. Common Stock and Shareholders’ Equity

MS&Co. and DWR are registered broker-dealers and registered futures commission merchants and, accordingly, are subject to the minimum net capital requirements of the Securities and Exchange Commission, the New York Stock Exchange and the Commodity Futures Trading Commission. MS&Co. and DWR have consistently operated in excess of these net capital requirements. MS&Co.’s net capital totaled $2,772 million at August 31, 1998, which exceeded the amount required by $2,206 million. DWR’s net capital totaled $597 million at August 31, 1998, which exceeded the amount required by $514 million. MSIL, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Securities and Futures Authority, and MSJL, a Tokyo-based broker-dealer, is subject to the capital requirements of the Japanese Ministry of Finance. MSIL and MSJL have consistently operated in excess of their respective regulatory capital requirements.

Under regulatory net capital requirements adopted by the Federal Deposit Insurance Corporation (“FDIC”) and other regulatory capital guidelines, FDIC-insured financial institutions must maintain (a) 3% to 5% of Tier 1 capital, as defined, to total assets (“leverage ratio”) and (b) 8% combined Tier 1 and Tier 2 capital, as defined, to risk weighted assets ("risk-weighted capital ratio"). At August 31, 1998, the leverage ratio and risk-weighted capital ratio of each of the Company's FDIC-insured financial institutions exceeded these and all other regulatory minimums.

Certain other U.S. and non-U.S. subsidiaries are subject to various securities, commodities and banking regulations, and capital adequacy requirements promulgated by the regulatory and exchange authorities of the countries in which they operate. These subsidiaries have consistently operated in excess of their local capital adequacy requirements.

6. Earnings per Share

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

	Three Months Ended August 31,		Nine Months Ended August 31,	
	1998	1997	1998	1997
Basic EPS:				
Net income	$ 645	$ 678	$2,190	$1,776
Less: preferred stock dividend requirements	(14)	(15)	(43)	(52)
Net income available to common shareholders	$ 631	$ 663	$2,147	$1,724
Weighted-average common shares outstanding	573	578	582	574
Basic EPS	$1.10	$1.15	$ 3.69	$ 3.00
Diluted EPS:				
Net income	$ 645	$ 678	$2,190	$1,776
Less: preferred stock dividend requirements after assumed conversion of ESOP preferred stock	(13)	(14)	(38)	(49)
Net income available to common shareholders	$ 632	$ 664	$2,152	$1,727
Weighted-average common shares outstanding	573	578	582	574
Effect of dilutive securities:				
Stock options	20	20	19	20
ESOP convertible preferred stock	12	12	12	12
Weighted-average common shares outstanding and common stock equivalents	605	610	613	606
Diluted EPS	$1.05	$ 1.09	$ 3.51	$ 2.85

7. Commitments and Contingencies

In the normal course of business, the Company has been named as a defendant in various lawsuits and has been involved in certain investigations and proceedings. Some of these matters involve claims for substantial amounts. Although the ultimate outcome of these matters cannot be ascertained at this time, it is the opinion of management, after consultation with outside counsel, that the resolution of such matters will not have a material adverse effect on the consolidated financial condition of the Company, but may be material to the Company's operating results for any particular period, depending upon the level of the Company's net income for such period.

The Company had approximately $5.8 billion and $5.5 billion of letters of credit outstanding at August 31, 1998 and at November 30, 1997 to satisfy various collateral requirements.

8. Derivative Contracts

In the normal course of business, the Company enters into a variety of derivative contracts related to financial instruments and commodities. The Company uses swap agreements in managing its interest rate exposure. The Company also uses forward and option contracts, futures and swaps in its trading activities; these financial instruments also are used to hedge the U.S. dollar cost of certain foreign currency exposures. In addition, financial futures and forward contracts are actively traded by the Company and are used to hedge proprietary inventory. The Company also enters into delayed delivery, when-issued, and warrant and option contracts involving securities. These instruments generally represent future commitments to swap interest payment streams, exchange currencies or purchase or sell other financial instruments on specific terms at specified future dates. Many of these products have maturities that do not extend beyond one year; swaps and options and warrants on equities typically have longer maturities. For further discussion of these matters, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations—Derivative Financial Investments" and Note 8 to the consolidated financial statements for the fiscal year ended November 30, 1997, included in the Form 10-K.

These derivative instruments involve varying degrees of off-balance sheet market risk. Future changes in interest rates, foreign currency exchange rates or the fair values of the financial instruments, commodities or indices underlying these contracts ultimately may result in cash settlements exceeding fair value amounts recognized in the condensed consolidated statements of financial condition, which, as described in Note 1, are recorded at fair value, representing the cost of replacing those instruments.

The Company's exposure to credit risk with respect to these derivative instruments at any point in time is represented by the fair value of the contracts reported as assets. These amounts are presented on a net-by-counterparty basis (when appropriate), but are not reported net of collateral, which the Company obtains with respect to certain of these transactions to reduce its exposure to credit losses.

The credit quality of the Company's trading-related derivatives at August 31, 1998 and November 30, 1997 is summarized in the tables below, showing the fair value of the related assets by counterparty credit rating. The credit ratings are determined by external rating agencies or by equivalent ratings used by the Company's Credit Department:

	AAA	AA	A	BBB	Collateralized Non-Investment Grade	Other Non-Investment Grade	Total
	(dollars in millions)						
At August 31, 1998							
Interest rate and currency swaps and options (including caps, floors and swap options) and other fixed income securities contracts	$ 876	$ 3,995	$ 3,539	$ 1,261	$ 65	$ 913	$ 10,649
Foreign exchange forward contracts and options	194	1,832	1,667	386	—	204	4,283
Mortgage-backed securities forward contracts, swaps and options	95	17	35	5	—	8	160
Equity securities contracts (including equity swaps, warrants and options)	2,079	1,343	491	605	926	111	5,555
Commodity forwards, options and swaps	69	398	328	620	20	429	1,864
Total	$ 3,313	$ 7,585	$ 6,060	$ 2,877	$ 1,011	$ 1,665	$ 22,511
Percent of total	15%	34%	27%	13%	4%	7%	100%
At November 30, 1997							
Interest rate and currency swaps and options (including caps, floors and swap options) and other fixed income securities contracts	$ 754	$ 2,761	$ 2,544	$ 436	$ 33	$ 568	$ 7,096
Foreign exchange forward contracts and options	788	2,504	1,068	72	—	176	4,608
Mortgage-backed securities forward contracts, swaps and options	156	90	50	2	—	10	308
Equity securities contracts (including equity swaps, warrants and options)	1,141	917	567	233	780	152	3,790
Commodity forwards, options and swaps	70	425	380	312	12	145	1,344
Total	$ 2,909	$ 6,697	$ 4,609	$ 1,055	$ 825	$ 1,051	$ 17,146
Percent of total	17%	39%	27%	6%	5%	6%	100%

A substantial portion of the Company's securities and commodities transactions are collateralized and are executed with and on behalf of commercial banks and other institutional investors, including other brokers and dealers. Positions taken and commitments made by the Company, including positions taken and underwriting and financing commitments made in connection with its private equity and other principal investment activities, often involve substantial amounts and significant exposure to individual issuers and businesses, including non-investment grade issuers. The Company seeks to limit concentration risk created in its businesses through a variety of separate but complementary financial, position and credit exposure reporting systems, including the use of trading limits based in part upon the Company's review of the financial condition and credit ratings of its counterparties.

See also "Risk Management" in the Form 10-K for discussions of the Company's risk management policies and procedures for its securities businesses.

9. Dispositions

During the quarter ended August 31, 1998, the Company completed the sale of its Correspondent Clearing business to NationsBanc Montgomery Securities, LLC ("NationsBanc"), a subsidiary of NationsBank Corporation. The gain resulting from the sale was not material to the Company's financial condition or results of operations.

During the quarter ended May 31, 1998, the Company completed the sale of its Prime Option^{SM} MasterCard® portfolio ("Prime Option"), a business it had operated with NationsBank of Delaware, N.A. The gain resulting from the sale was not material to the Company's financial condition or results of operations.

On April 18, 1998, SPS Transaction Services, Inc. ("SPS") and Associates First Capital Corporation ("Associates") entered into a stock purchase agreement (the "Purchase Agreement") pursuant to which SPS agreed to sell substantially all of its assets to Associates. SPS is a 73% owned, publicly held subsidiary of the Company which provides a range of technology outsourcing services, including the processing of credit and debit card transactions, consumer private label credit card programs, commercial account processing services, and call center customer service activities in the U.S. The transaction is subject to the conditions of the Purchase Agreement and is expected to close by the end of fiscal 1998.

On May 7, 1998, the Company and Chase Manhattan Corporation ("Chase") announced that they had reached a definitive agreement pursuant to which the Company agreed to sell its Global Custody business to Chase. On September 30, 1998 this transaction was completed.

The expected gains resulting from the sale of SPS and the Global Custody business will be recognized by the Company during the period in which the respective transactions are completed.

10. Subsequent Events

In September 1998, the Company made an investment of $300 million in the Long-Term Capital Portfolio, L.P. ("LTCP"). The Company is a member of a consortium of 14 financial institutions participating in an equity recapitalization of LTCP. The objectives of this investment, the term of which is three years, are to continue active management of its positions and, over time, to reduce excessive risk exposures and leverage, return capital to the participants and ultimately realize the potential value of the LTCP portfolio.

INDEPENDENT ACCOUNTANTS' REPORT

To the Directors and Shareholders of
Morgan Stanley Dean Witter & Co.

We have reviewed the accompanying condensed consolidated statement of financial condition of Morgan Stanley Dean Witter & Co. and subsidiaries (formerly Morgan Stanley, Dean Witter, Discover & Co.) as of August 31, 1998, and the related condensed consolidated statements of income for the three and nine month periods ended August 31, 1998 and 1997, and cash flows for the nine month periods ended August 31, 1998 and 1997. These condensed consolidated financial statements are the responsibility of the management of Morgan Stanley Dean Witter & Co. We were furnished with the report of other accountants on their review of the interim financial information of Morgan Stanley Group Inc. and subsidiaries for the quarter ended February 28, 1997, which statements reflect total revenues of $4,076 million for the three month period ended February 28, 1997.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review and the report of other accountants, we are not aware of any material modifications that should be made to such condensed consolidated financial statements for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the consolidated statement of financial condition of Morgan Stanley Dean Witter & Co. and subsidiaries as of November 30, 1997, and the related consolidated statements of income, cash flows and changes in shareholders' equity for the fiscal year then ended (not presented herein), included in Morgan Stanley Dean Witter & Co.'s Annual Report on Form 10-K for the fiscal year ended November 30, 1997; and in our report dated January 23, 1998, we expressed an unqualified opinion on those consolidated financial statements based on our audit and the report of other auditors.

/S/ DELOITTE & TOUCHE LLP

New York, New York
October 14, 1998

INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Stockholders and Board of Directors of
Morgan Stanley Group Inc.

We have reviewed the condensed consolidated statement of financial condition of Morgan Stanley Group Inc. and subsidiaries (the "Company") as of February 28, 1997 and the related condensed consolidated statements of income and cash flows for the three-month period ended February 28, 1997 (not presented separately herein). These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated financial statements referred to above for them to be in conformity with generally accepted accounting principles.

/S/ ERNST & YOUNG LLP

New York, New York
March 27, 1997

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

The Merger

On May 31, 1997, Morgan Stanley Group Inc. ("Morgan Stanley") was merged with and into Dean Witter, Discover & Co. ("Dean Witter Discover") (the "Merger"). At that time, Dean Witter Discover changed its corporate name to Morgan Stanley, Dean Witter, Discover & Co. ("MSDWD"). In conjunction with the Merger, each share of Morgan Stanley common stock then outstanding was converted into 1.65 shares of MSDWD's common stock and each share of Morgan Stanley preferred stock was converted into one share of a corresponding series of preferred stock of MSDWD. The Merger was treated as a tax-free exchange.

On March 24, 1998, MSDWD changed its corporate name to Morgan Stanley Dean Witter & Co. (the "Company").

Basis of Financial Information and Change in Fiscal Year End

The condensed consolidated financial statements give retroactive effect to the Merger, which was accounted for as a pooling of interests. The pooling of interests method of accounting requires the restatement of all periods presented as if Dean Witter Discover and Morgan Stanley had always been combined.

Prior to the Merger, Dean Witter Discover's year ended on December 31 and Morgan Stanley's fiscal year ended on November 30. Subsequent to the Merger, the Company adopted a fiscal year end of November 30. All information included herein reflects the change in fiscal year end.

Results of Operations*

Certain Factors Affecting Results of Operations

The Company's results of operations may be materially affected by market fluctuations and economic factors. In addition, results of operations in the past have been and in the future may continue to be materially affected by many factors of a global nature, including economic and market conditions; the availability of capital; the level and volatility of interest rates; currency values and other market indices; the availability of credit; inflation; and legislative and regulatory developments. Such factors may also have an impact on the Company's ability to achieve its strategic objectives, including (without limitation) profitable global expansion.

The Company's Securities and Asset Management business, particularly its involvement in primary and secondary markets for all types of financial products, including derivatives, is subject to substantial positive and negative fluctuations due to a variety of factors that cannot be predicted with great certainty, including variations in the fair value of securities and other financial products and the volatility and liquidity of trading markets. Fluctuations also occur due to the level of market activity, which, among other things, affects the flow of investment dollars into mutual funds, and the size, number and timing of transactions or assignments (including realization of returns from the Company's private equity investments).

In the Company's Credit and Transaction Services business, changes in economic variables may substantially affect consumer loan growth and credit quality. Such variables include the number of personal bankruptcy filings, the rate of unemployment and the level of consumer debt as a percentage of income.

The Company's results of operations also may be materially affected by competitive factors. In addition to competition from firms traditionally engaged in the securities business, there has been increased competition from other

* This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, as well as a discussion of some of the risks and uncertainties involved in the Company's business that could affect the matters referred to in such statements.

sources, such as commercial banks, insurance companies, mutual fund groups and other companies offering financial services both in the U.S. and globally. As a result of recent and pending legislative and regulatory initiatives in the U.S. to remove or relieve certain restrictions on commercial banks, competition in some markets that have traditionally been dominated by investment banks and retail securities firms has increased and may continue to increase in the near future. In addition, recent and continuing convergence and consolidation in the financial services industry will lead to increased competition from larger diversified financial services organizations.

Such competition, among other things, affects the Company's ability to attract and retain highly skilled individuals. Competitive factors also affect the Company's success in attracting and retaining clients and assets by its ability to meet investors' saving and investment needs through consistency of investment performance and accessibility to a broad array of financial products and advice. In the credit services industry, competition centers on merchant acceptance of credit cards, credit card account acquisition and customer utilization of credit cards. Merchant acceptance is based on both competitive transaction pricing and the volume of credit cards in circulation. Credit card account acquisition and customer utilization are driven by the offering of credit cards with competitive and appealing features such as no annual fees, low introductory and attractive interest rates, and other customized features targeting specific consumer groups and by having broad merchant acceptance.

As a result of the above economic and competitive factors, net income and revenues in any particular period may not be representative of full-year results and may vary significantly from year to year and from quarter to quarter. The Company intends to manage its business for the long term and help mitigate the potential effects of market downturns by strengthening its competitive position in the global financial services industry through diversification of its revenue sources and enhancement of its global franchise. The Company's ability and success in maintaining high levels of profitable business activities, emphasizing fee-based assets that are designed to generate a continuing stream of revenues, managing risks in both the Securities and Asset Management and Credit and Transaction Services businesses, evaluating credit product pricing and monitoring costs will continue to affect its overall financial results. In addition, the complementary trends in the financial services industry of consolidation and globalization present, among other things, technological, risk management and other infrastructure challenges that will require effective resource allocation in order for the Company to remain competitive.

Economic and Market Conditions in the Quarter Ended August 31, 1998

Conditions in the global financial markets during the third quarter of fiscal 1998 were extremely turbulent, particularly during the month of August, resulting in difficult conditions in many global financial markets.

In the U.S., the domestic economy continued to exhibit signs of growth, as high levels of consumer spending and relatively low levels of inflation and unemployment existed during the quarter. The Federal Reserve Board decided to leave the overnight lending rate unchanged during the quarter in light of the stability of the U.S. economy and fragility in certain global financial markets. However, during the last month of the quarter U.S. financial markets were adversely impacted by investor reaction to the severe economic turmoil in Asia, Russia and certain emerging market nations. Fears of lower corporate earnings and a slowing rate of economic growth caused difficult conditions in the equity and fixed income markets, while U.S. Treasury yields fell to record lows as investors sought a safe haven from riskier financial instruments.

Conditions in European markets were also volatile during the quarter. While the region continued to benefit from positive investor sentiment relating to the approaching European Economic and Monetary Union ("EMU"), many European financial markets were negatively impacted by developments in Russia. The Russian economy was adversely affected by the difficult conditions in Asia, declining oil prices and an unstable political infrastructure. These factors contributed to a significant reduction of investor confidence, causing sizable declines and extreme volatility in Russian financial markets during the quarter. Investor confidence was further shaken when the Russian government announced plans to restructure its external debt obligations and to allow the ruble to devalue in order to stabilize the nation's currency rate and banking system. While the fallout from these developments affected many European markets, German markets were particularly vulnerable due to their strong economic and commercial ties to Russia and exposure to Russian debt.

Market conditions in the Far East continued to be weak due to the ongoing economic and financial difficulties that have existed in the region since the latter half of fiscal 1997. The Japanese economy continued to struggle due to shrinking consumer demand, declining corporate profits, rising unemployment and deflation. While these conditions contributed to the resignation of Japan's Prime Minister during the quarter, many investors expressed uncertainty about the new government's ability to improve the nation's economic performance. Market conditions were also unstable elsewhere in Asia, as the poor economic performance of Japan and the persistent weakness of the yen continued to adversely affect the financial markets of many nations within the region.

Instability in the global financial markets has continued in the fourth quarter.

Results of the Company for the Quarter and Nine Month Periods ended August 31, 1998 and 1997

The Company's net income of $645 million and $2,190 million in the quarter and nine month period ended August 31, 1998 represented a decrease of 5% as compared to the third quarter of fiscal 1997 and an increase of 19% from the comparable nine month period of fiscal 1997. Diluted earnings per common share were $1.05 and $3.51 in the quarter and nine month period ended August 31, 1998 as compared to $1.09 and $2.85 in the quarter and nine month period ended August 31, 1997. The Company's annualized return on common equity was 19.3% and 21.5% for the quarter and nine month period ended August 31, 1998, as compared to 22.8% and 20.6% for the comparable periods of fiscal 1997.

The decrease in net income in the quarter ended August 31, 1998 from the quarter ended August 31, 1997 was primarily due to lower revenues from principal trading and principal investment activities. These decreases were partially offset by higher commission revenues, increased asset management, distribution and administration fees, improved operating results from the Company's Credit and Transaction Services business, and lower incentive-based compensation expenses. The increase in net income in the nine month period ended August 31, 1998 from the comparable prior year period was primarily due to higher revenues from securities and asset management activities, including investment banking, commissions and asset management, distribution and administration fees, partially offset by lower principal investment revenues and higher incentive-based compensation expenses.

In the nine month period ended August 31, 1998, the Company entered into several transactions that reflect its strategic decision to focus on growing its core Securities and Asset Management and Credit and Transaction Services businesses.

During the quarter ended May 31, 1998, the Company completed the sale of its Prime Option℠ MasterCard® portfolio ("Prime Option"), a business it had operated with NationsBank of Delaware N.A. The gain resulting from the sale was not material to the Company's financial condition or results of operations.

During the quarter ended August 31, 1998, the Company completed the sale of its Correspondent Clearing business to NationsBanc Montgomery Securities, LLC ("NationsBanc"), a subsidiary of NationsBank Corporation. The gain resulting from the sale was not material to the Company's financial condition or results of operations.

On April 18, 1998, SPS Transaction Services, Inc. ("SPS") and Associates First Capital Corporation ("Associates") entered into a stock purchase agreement (the "Purchase Agreement") pursuant to which SPS agreed to sell substantially all of its assets to Associates. SPS is a 73% owned, publicly held subsidiary of the Company which provides a range of technology outsourcing services, including the processing of credit and debit card transactions, consumer private label credit card programs, commercial account processing services, and call center customer service activities in the U.S. The transaction is subject to the conditions of the Purchase Agreement and is expected to close by the end of fiscal 1998.

On May 7, 1998, the Company and Chase Manhattan Corporation ("Chase") announced that they had reached a definitive agreement pursuant to which the Company agreed to sell its Global Custody business to Chase. On September 30, 1998 this transaction was completed.

The expected gains resulting from the sale of SPS and the Global Custody business will be recognized by the Company during the period in which the respective transactions are completed.

The remainder of Results of Operations is presented on a business segment basis. Substantially all of the operating revenues and operating expenses of the Company can be directly attributable to its two business segments: Securities and Asset Management and Credit and Transaction Services. Certain reclassifications have been made to prior period amounts to conform to the current year's presentation.

Securities and Asset Management

Statements of Income (dollars in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	1998	1997	1998	1997
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 819	$ 818	$2,607	$ 1,921
Principal transactions:				
Trading	499	778	2,493	2,369
Investments	(174)	206	(1)	398
Commissions	599	550	1,740	1,515
Asset management, distribution and administration fees	718	656	2,135	1,853
Interest and dividends	3,601	2,758	10,291	7,776
Other	41	38	138	100
Total revenues	6,103	5,804	19,403	15,932
Interest expense	3,145	2,462	9,300	7,079
Net revenues	2,958	3,342	10,103	8,853
Non-interest expenses:				
Compensation and benefits	1,464	1,713	4,980	4,437
Occupancy and equipment	128	118	375	343
Brokerage, clearing and exchange fees	122	126	365	330
Information processing and communications	171	141	479	432
Marketing and business development	118	101	350	297
Professional services	150	103	387	261
Other	138	146	391	386
Total non-interest expenses	2,291	2,448	7,327	6,486
Income before income taxes	667	894	2,776	2,367
Income tax expense	197	350	1,027	917
Net income	$ 470	$ 544	$1,749	$ 1,450

Securities and Asset Management net revenues of $2,958 million in the quarter ended August 31, 1998 represented a decrease of 11% from the quarter ended August 31, 1997. Net revenues of $10,103 million in the nine month period ended August 31, 1998 represented an increase of 14% from the comparable period of fiscal 1997. Securities and Asset Management net income of $470 million in the quarter ended August 31, 1998 represented a decrease of 14% from the quarter ended August 31, 1997, while net income of $1,749 million for the nine month period ended August 31, 1998 increased 21% over the comparable period of fiscal 1997. The decreases in the quarterly period were primarily attributable to lower revenues from principal trading and lower principal investment gains, partially offset by higher commissions revenues, asset management, distribution and administration fees, net interest revenues and lower incentive-based compensation expenses. The increases in the nine month period were primarily due to higher investment banking revenues, commissions revenues, asset management, distribution and administration fees and net interest revenues, partially offset by lower principal investment revenues and higher incentive-based compensation expenses.

Investment Banking

Investment banking revenues are derived from the underwriting of securities offerings and fees from advisory services. Investment banking revenues in the quarter ended August 31, 1998 were comparable to the quarter ended August 31, 1997, as higher revenues from merger, acquisition and restructuring activities were offset by lower revenues from debt and equity underwritings.

Revenues from merger, acquisition and restructuring activities increased to record levels, as the global market for such transactions continued to be robust during the quarter. The aggregate value of announced global transactions was approximately $1.7 trillion through August 31, 1998, which was twice the volume reported in the comparable period of

1997. The high level of transaction activity reflected the continuing trend of consolidation and globalization across many industry sectors, as companies attempted to expand into new markets and businesses through strategic combinations. Advisory fees from real estate transactions also increased during the quarter. Favorable market conditions, driven by consolidation activities in the U.S. and a recovering real estate market in Europe, contributed to the increase.

Fixed income underwriting revenues decreased, primarily attributable to lower revenues from issuances of global high yield fixed income securities. The market for high yield fixed income securities was adversely affected by high levels of volatility in the global financial markets, primarily resulting from the difficult conditions in Asia and Russia, which caused credit spreads to increase. In addition, the demand for high yield securities declined as many investors preferred higher credit quality instruments.

Equity underwriting revenues also decreased, as the significant level of volatility in the global financial markets during the quarter contributed to a lower volume of equity offerings as compared to the prior year period.

In the nine month period ended August 31, 1998, investment banking revenues increased 36% from the comparable period of 1997, reflecting higher revenues from merger and acquisition transactions as well as from both debt and equity underwritings.

Principal Transactions

Principal transaction trading revenues, which include revenues from customer purchases and sales of securities in which the Company acts as principal and gains and losses on securities held for resale, including derivatives, decreased 36% in the quarter ended August 31, 1998 from the comparable period of fiscal 1997. The decrease was primarily due to lower fixed income trading revenues, partially offset by higher equity, foreign exchange and commodity trading revenues.

Fixed income trading revenues decreased significantly in the quarter ended August 31, 1998 from the quarter ended August 31, 1997, primarily due to lower revenues from trading in investment grade, high yield, securitized and other credit sensitive fixed income securities. Revenues from investment grade fixed income securities were adversely affected by the difficult economic conditions in Asia, Russia and other emerging markets. Investor preferences shifted towards less risky financial instruments, principally to U.S. Treasury securities. This negatively affected the trading of credit sensitive fixed income products by widening credit spreads, reducing liquidity, and de-coupling the historical price relationships between credit sensitive securities and government bonds. Revenues from high yield fixed income securities were also impacted by the significant downturn in the global financial markets, as investors became concerned about the impact of a prolonged economic downturn on high yield issuers. Revenues from securitized fixed income securities also declined, as the relatively low interest rate environment in the U.S. led to greater prepayment levels and wider spreads.

Equity trading revenues in the quarter ended August 31, 1998 were higher than the comparable prior year period. Revenues from trading in equity cash products increased, primarily due to higher activity in European markets. European equity trading revenues benefited from the Company’s increased sales and research coverage of the region that began in mid-1997. In addition, trading volumes were higher in many European markets due to positive investor sentiment regarding the approaching EMU. Revenues from trading equity derivative securities also increased, benefiting from higher levels of volatility, particularly in technology stocks in U.S. markets.

Foreign exchange trading revenues also increased in the quarter ended August 31, 1998. The increase was attributable to high levels of customer transaction volume and volatility in the foreign exchange markets. Certain Asian nations continued to experience adverse economic conditions and slumping equity markets. These factors, coupled with continued weakness in the Japanese yen, increased the levels of customer transaction volume and market volatility. In addition, the economic and political turmoil in Russia led to the collapse of the ruble and resulted in higher levels of volatility in certain European currencies, particularly the German mark.

Commodity trading revenues increased to record levels in the quarter ended August 31, 1998, primarily driven by higher revenues from trading in electricity and crude oil products. Electricity trading revenues benefited from an increase in the demand for electric power, as portions of the Midwest and Atlantic regions of the U.S. experienced a summer heat wave during the quarter. These conditions caused a significant increase in the price of electricity, particularly during the month of June, 1998. Revenues from trading crude oil products benefited from declining energy prices throughout much of the quarter, reflecting the impact of a high level of supply, low customer demand and the continuing economic turmoil in Asia.

Principal transaction investment losses aggregating $174 million were recorded in the quarter ended August 31, 1998, as compared to gains of $206 million in the comparable prior year period. Fiscal 1998's results primarily reflect losses from an institutional leveraged emerging markets debt portfolio, partially offset by gains of $129 million resulting from increases in the value of certain private equity investments, including gains from the initial public offering of Equant, a Netherlands based data communications company.

Principal transaction trading revenues for the nine month period ended August 31, 1998 increased 5% from the comparable prior year period. Fixed income trading revenues decreased due to lower revenues from trading investment grade, high yield and securitized fixed income securities, primarily resulting from the difficult market conditions that existed during the third quarter of fiscal 1998. Equity trading revenues increased, primarily due to higher revenues from European equity cash products. European revenues benefited from the generally favorable performance of most equity markets within the region, high customer transaction volumes and positive investor sentiment regarding the approaching EMU. Higher trading revenues from equity derivative securities also contributed to the increase. Foreign exchange trading revenues increased, benefiting from high levels of volatility in the currency markets, particularly in Asia, and strong customer trading volumes. Commodities trading revenues increased due to higher revenues from precious metals, crude oil and electricity.

Principal transaction investment losses aggregating $1 million were recorded in the nine month period ended August 31, 1998 as compared to gains of $398 million in the comparable prior year period. Fiscal 1998's results reflect losses from an institutional leveraged emerging markets debt portfolio that occurred during the third quarter, partially offset by gains from increases in the carrying values of certain private equity investments.

Commissions

Commission revenues primarily arise from agency transactions in listed and over-the-counter equity securities, and sales of mutual funds, futures, insurance products and options. Commission revenues increased 9% in the quarter ended August 31, 1998 from the comparable period of fiscal 1997. In the U.S., the high levels of market volatility contributed to an increased volume of customer securities transactions. Revenues from markets in Europe benefited from the continuance of high trading volumes in the region, as well as from the Company's increased sales and research activities in the region. The Company's addition of over 900 financial advisors since August 31, 1997 also contributed to the increase.

Commission revenues increased 15% in the nine month period ended August 31, 1998 from the comparable period in fiscal 1997. The increase primarily reflects increased customer trading activity in the global markets for equity securities, as well as an increased number of financial advisors.

Asset Management, Distribution and Administration Fees

Asset management, distribution and administration revenues include fees for asset management services, including fund management fees which are received for investment management, fees received for promoting and distributing mutual funds ("12b-1 fees"), and other administrative fees and non-interest revenues earned from correspondent clearing and custody services. Fund management fees arise from investment management services the Company provides to registered investment companies (the "Funds") pursuant to various contractual arrangements. The Company receives management fees based upon each Fund's average daily net assets. The Company receives 12b-1 fees for services it provides in promoting and distributing certain open-ended Funds. These fees are based on either the average daily Fund net asset balances or average daily aggregate net Fund sales and are affected by changes in the overall level and mix of assets under management and administration. The Company also receives fees from investment management services provided to segregated customer accounts pursuant to various contractual arrangements.

Asset management, distribution and administration revenues increased 9% in the quarter ended August 31, 1998 from the comparable period of fiscal 1997, primarily reflecting higher fund management and 12b-1 fees as well as other revenues resulting from a higher level of assets under management. These increases were partially offset by the impact of market depreciation on certain of the Company's products resulting from the difficult conditions existing in the global financial markets during the latter portion of the quarter.

In the nine month period ended August 31, 1998, asset management, distribution and administration revenues increased 15% from the comparable period in fiscal 1997. The increase primarily reflects higher fund management and 12b-1 fees as well as other revenues resulting from a higher level of assets under management.

Customer assets under management or supervision increased to $356 billion at August 31, 1998 from $325 billion at August 31, 1997. The increase in assets under management or supervision primarily reflected net inflows of customer assets. In addition, appreciation in the value of existing customer portfolios also contributed to the increases. Customer assets under management or supervision included products offered primarily to individual investors of $200 billion at August 31, 1998 and $186 billion at August 31, 1997. Products offered primarily to institutional investors were $156 billion at August 31, 1998 and $139 billion at August 31, 1997.

Net Interest

Interest and dividend revenues and expense are a function of the level and mix of total assets and liabilities, including financial instruments owned, reverse repurchase and repurchase agreements and customer margin loans, and the prevailing level, term structure and volatility of interest rates. Interest and dividend revenues and expense should be viewed in the broader context of principal trading and investment banking results. Decisions relating to principal transactions in securities are based on an overall review of aggregate revenues and costs associated with each transaction or series of transactions. This review includes an assessment of the potential gain or loss associated with a trade, the interest income or expense associated with financing or hedging the Company's positions, and potential underwriting, commission or other revenues associated with related primary or secondary market sales. Net interest revenues increased 54% and 42% in the quarter and nine month period ended August 31, 1998 from the comparable periods of fiscal 1997. In both periods, the increases were primarily attributable to higher levels of revenues from net interest earning assets, including financial instruments owned and customer margin receivable balances. Higher levels of securities lending transactions also had a positive effect on net interest and dividend revenues. These increases were partially offset by higher interest expense associated with a higher level of interest bearing liabilities, including long-term debt.

Non-Interest Expenses

Total non-interest expenses decreased 6% in the quarter ended August 31, 1998 from the quarter ended August 31, 1997. Total non-interest expenses increased 13% in the nine month period ended August 31, 1998 from the comparable period of fiscal 1997. Within the non-interest expense category, compensation and benefits expense decreased 15% in the quarterly period, principally reflecting decreased incentive compensation based on lower levels of revenues and earnings. During the nine month period, compensation and benefits expense increased 12%, reflecting the higher level of revenues and earnings and its impact on incentive based compensation. Excluding compensation and benefits expense, non-interest expenses increased 13% in the quarter and 15% in the nine month period ended August 31, 1998. Occupancy and equipment expenses increased 8% and 9% in the quarter and nine month period, respectively, primarily due to increased office space in New York and Hong Kong, higher occupancy costs in London, and additional rent associated with 28 new branch locations in the U.S. Brokerage, clearing and exchange fees decreased 3% in the quarter and increased 11% in the nine month period. The decrease in the quarter was primarily attributable to lower agent bank costs, partially offset by higher securities trading volume. The increase in the nine month period reflects the higher level of securities trading volume as well as the Company's acquisition of the institutional global custody business of Barclays Bank PLC on April 3, 1997. Information processing and communications expense increased 21% and 11% in the quarter and nine month period, respectively, primarily due to the impact of increased rates for certain data services as well as other telecommunications and information systems costs. A higher number of employees utilizing communications systems also contributed to the increase. Marketing and business development expenses increased 17% and 18% in the quarter and nine month period, respectively, reflecting increased travel and entertainment costs associated with the continued high levels of activity in the global financial markets as the Company continues to develop new business. Professional services expenses increased 46% and 48% in the quarter and nine month period, respectively, primarily reflecting higher consulting costs associated with certain information technology initiatives, including the preparation for EMU and Year 2000, coupled with the Company's increased global business activities. Higher temporary staff, legal costs and employment fees also contributed to the increase. Other expenses decreased 5% in the quarter and increased 1% in the nine month period. The decrease in the quarter is primarily due to lower costs for certain tax matters and other operating costs as compared to the prior year period. The increase in the nine month period primarily reflects increases in various expense items resulting from the Company's higher level of global business and trading activities.

Credit and Transaction Services

Statements of Income (dollars in millions)

	Three Months Ended August 31, 1998	Three Months Ended August 31, 1997	Nine Months Ended August 31, 1998	Nine Months Ended August 31, 1997
	(unaudited)		(unaudited)	
Fees:				
Merchant and cardmember	$ 438	$433	$1,270	$1,293
Servicing	255	196	658	582
Commissions	9	9	26	18
Other	11	3	16	8
Total non-interest revenues	713	641	1,970	1,901
Interest revenue	682	812	2,138	2,360
Interest expense	232	303	776	873
Net interest income	450	509	1,362	1,487
Provision for consumer loan losses	280	385	960	1,140
Net credit income	170	124	402	347
Net revenues	883	765	2,372	2,248
Compensation and benefits	145	136	434	407
Occupancy and equipment	20	16	56	46
Brokerage, clearing and exchange fees	4	4	12	8
Information processing and communications	120	108	354	354
Marketing and business development	236	192	584	558
Professional services	26	24	73	58
Other	55	73	158	193
Total non-interest expenses	606	553	1,671	1,624
Income before income taxes	277	212	701	624
Provision for income taxes	102	78	260	235
Net income	$ 175	$134	$ 441	$ 389

Credit and Transaction Services net income of $175 million and $441 million in the quarter and nine month period ended August 31, 1998 represented an increase of 31% and 13% from the comparable periods of 1997. The quarterly net income represented a record level for the Company. The increase in net income in both periods was primarily attributable to a lower provision for loan losses and an increase in fee revenue, partially offset by an increase in non-interest expenses.

As a result of enhancements made to certain of the Company's operating systems in the fourth quarter of fiscal 1997, the Company began recording charged off cardmember fees and interest revenue directly against the income statement line items to which they were originally recorded. Prior to the enhancements, charged off cardmember fees and interest revenue were both recorded as a reduction of interest revenue. While this change has no impact on net revenues, the Company believes that the revised presentation better reflects the manner in which charge-offs affect the Credit and Transaction Services statements of income. However, since prior periods have not been restated to reflect this change, the comparability of merchant and cardmember fees and interest revenues between the quarter and nine month period ended August 31, 1998 and the quarter and nine month period ended August 31, 1997 has been affected. Accordingly, the following sections will also discuss the changes in these income statement categories excluding the impact of this reclassification.

Non-Interest Revenues

Total non-interest revenues increased 11% in the quarter ended August 31, 1998 and 4% in the nine month period ended August 31, 1998 from the comparable periods of 1997. Excluding the effect of the reclassification of charged off cardmember fees discussed above, non-interest revenue would have increased 15% and 7% in the quarter and nine month period ended August 31, 1998.

Merchant and cardmember fees include revenues from fees charged to merchants on credit card sales, late payment fees, overlimit fees, insurance fees, cash advance fees, and fees for the administration of credit card programs and transaction processing services. Merchant and cardmember fees increased 1% in the quarter ended August 31, 1998 and decreased 2% in the nine month period ended August 31, 1998 from the comparable periods of 1997. Excluding the effect of the reclassification of charged off cardmember fees discussed above, merchant and cardmember fees would have increased 6% and 4% in the quarter and nine month period ended August 31, 1998. The increase in both periods was due to an increase in merchant discount revenue associated with increased sales volume partially offset by a decrease in cash advance fees and the effect of a higher level of securitized loans during the quarter. Cash advance fees decreased as a result of decreased cash advance transaction volume, primarily attributable to limits on cash advances imposed by the Company in an effort to reduce charge-offs.

Servicing fees are revenues derived from consumer loans that have been sold to investors through asset securitizations. Cash flows from the interest yield and cardmember fees generated by securitized loans are used to pay investors in these loans a predetermined fixed or floating rate of return on their investment, to reimburse investors for losses of principal through charged off loans and to pay the Company a fee for servicing the loans. Any excess cash flows remaining are paid to the Company. The servicing fees and excess net cash flows paid to the Company are reported as servicing fees in the condensed consolidated statements of income. The sale of consumer loans through asset securitizations therefore has the effect of converting portions of net credit income and fee income to servicing fees. The Company completed asset securitizations of $1,234 million in the quarter ended August 31, 1998 and $3,444 million in the nine month period ended August 31, 1998. During the comparable periods of 1997, the Company completed asset securitizations of $789 million. The asset securitizations in fiscal 1997 and 1998 have expected maturities ranging from 3 years to 10 years from the date of issuance.

The table below presents the components of servicing fees (dollars in millions):

	Three Months Ended August 31,		**Nine Months Ended August 31,**	
	1998	**1997**	**1998**	**1997**
Merchant and cardmember fees	$ 139	$108	$ 359	$ 325
Interest revenue	683	512	1,910	1,547
Interest expense	(269)	(204)	(754)	(611)
Provision for consumer loan losses	(298)	(220)	(857)	(679)
Servicing fees	$ 255	$196	$ 658	$ 582

Servicing fees increased 30% in the quarter ended August 31, 1998 and 13% in the nine months ended August 31, 1998 from the comparable periods of 1997. The increase in both periods was due to higher levels of net interest cash flows and increased fee revenue, partially offset by increased credit losses from securitized consumer loans. The increases in net interest, fee revenue and credit losses were primarily a result of higher levels of average securitized loans.

Commission revenues arise from customer securities transactions associated with Discover Brokerage Direct, Inc. (“DBD”), the Company’s provider of electronic brokerage services acquired in January 1997. Commissions revenue remained level in the quarter ended August 31, 1998 and increased 44% in the nine month period ended August 31, 1998 from the comparable periods of 1997. The increase in the nine month period ended August 31, 1998 was due to higher customer transaction volume as well as the inclusion of DBD’s results for nine months in 1998 as compared to seven months in 1997.

Net Interest Income

Net interest income is equal to the difference between interest revenue derived from Credit and Transaction Services consumer loans and short-term investment assets and interest expense incurred to finance those assets. Credit and Transaction Services assets, consisting primarily of consumer loans, earn interest revenue at both fixed rates and market-indexed variable rates. The Company incurs interest expense at fixed and floating rates. Interest expense also includes the effects of interest rate contracts entered into by the Company as part of its interest rate risk management program. This program is designed to reduce the volatility of earnings resulting from changes in interest rates and is accomplished primarily through matched financing, which entails matching the repricing schedules of consumer loans and related financing. Net interest income decreased 12% and 8% in the quarter and nine month period ended August 31, 1998 from the comparable periods of 1997. Excluding the effect of the reclassification of charged off cardmember fees discussed above, net interest income would have decreased 15% and 11% from the comparable prior year periods. The decrease in the quarter ended August 31, 1998 was predominately due to lower average levels of owned consumer loans partially offset by a higher yield on general purpose credit card loans reflective of the sale of Prime Option. The decrease in the nine month period ended August 31, 1998 was due to lower average levels of owned consumer loans and a lower yield on general purpose credit card loans. In both periods, the decrease in owned general purpose credit card loans was primarily due to an increase in securitized loans and the sale of Prime Option. The lower yield on general purpose credit card loans in the nine month period ended August 31, 1998 was due to a larger number of cardmembers taking advantage of promotional rates.

The following tables present analyses of Credit and Transaction Services average balance sheets and interest rates for the quarter and nine month period ended August 31, 1998 and 1997 and changes in net interest income during those periods:

Average Balance Sheet Analysis (dollars in millions)

	Three Months Ended August 31,					
	1998			1997		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
ASSETS						
Interest earning assets:						
General purpose credit card loans	$15,913	14.61%	$ 586	$20,017	14.19%	$ 716
Other consumer loans	1,503	16.99%	65	1,667	15.90%	66
Investment securities	460	5.56%	7	158	5.49%	2
Other	1,498	6.58%	24	1,698	6.18%	28
Total interest earning assets	19,374	13.96%	682	23,540	13.67%	812
Allowance for loan losses	(836)			(831)		
Non-interest earning assets	1,602			1,509		
Total assets	$20,140			$24,218		
LIABILITIES & SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 1,211	4.93%	$ 15	$ 924	4.08%	$ 10
Brokered	5,643	6.53%	93	4,963	6.64%	83
Other time	2,047	6.24%	32	2,229	6.15%	35
Total interest bearing deposits	8,901	6.25%	140	8,116	6.22%	128
Other borrowings	6,079	5.97%	92	11,300	6.17%	175
Total interest bearing liabilities	14,980	6.13%	232	19,416	6.19%	303
Shareholder's equity/other liabilities	5,160			4,802		
Total liabilities & shareholder's equity	$20,140			$24,218		
Net interest income			$ 450			$ 509
Net interest margin			9.22 %			8.57%
Interest rate spread		7.83%			7.48%	

Average Balance Sheet Analysis (dollars in millions)

	Nine Months Ended August 31,					
	1998			1997		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
ASSETS						
Interest earning assets:						
General purpose credit card loans	$17,559	14.02%	$1,849	$19,494	14.17%	$2,073
Other consumer loans	1,575	16.70%	198	1,823	15.51%	212
Investment securities	435	6.70%	22	182	5.46%	7
Other	1,419	6.54%	69	1,475	6.03%	68
Total interest earning assets	20,988	13.57%	2,138	22,974	13.68%	2,360
Allowance for loan losses	(857)			(812)		
Non-interest earning assets	1,640			1,508		
Total assets	$21,771			$23,670		
LIABILITIES & SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 1,015	4.82%	$ 37	$ 992	4.25%	$ 32
Brokered	5,877	6.60%	291	4,250	6.68%	213
Other time	2,203	6.16%	102	2,205	6.11%	101
Total interest bearing deposits	9,095	6.29%	430	7,447	6.19%	346
Other borrowings	7,635	6.04%	346	11,604	6.05%	527
Total interest bearing liabilities	16,730	6.18%	776	19,051	6.11%	873
Shareholder's equity/other liabilities	5,041			4,619		
Total liabilities & shareholder's equity	$21,771			$23,670		
Net interest income			$1,362			$1,487
Net interest margin			8.64%			8.62%
Interest rate spread		7.39%			7.57%	

Rate/Volume Analysis (dollars in millions)

	Three Months Ended August 31, 1998 vs. 1997 Increase/(Decrease) Due to Changes in			Nine Months Ended August 31, 1998 vs. 1997 Increase/(Decrease) Due to Changes in		
	Volume	Rate	Total	Volume	Rate	Total
INTEREST REVENUE						
General purpose credit card loans	$(147)	$ 17	$(130)	$ (204)	$(20)	$(224)
Other consumer loans	(6)	5	(1)	(28)	14	(14)
Investment securities	5	—	5	11	4	15
Other	(5)	1	(4)	(3)	4	1
Total interest revenue	(144)	14	(130)	(205)	(17)	(222)
INTEREST EXPENSE						
Interest bearing deposits						
Savings	3	2	5	1	4	5
Brokered	12	(2)	10	82	(4)	78
Other time	(3)	—	(3)	—	1	1
Total interest bearing deposits	11	1	12	77	7	84
Other borrowings	(80)	(3)	(83)	(180)	(1)	(181)
Total interest expense	(69)	(2)	(71)	(106)	9	(97)
Net interest income.	$ (75)	$ 16	$ (59)	$ (99)	$(26)	$(125)

The supplemental table below provides average managed loan balance and rate information which takes into account both owned and securitized loans:

Supplemental Average Managed Loan Balance Sheet Information (dollars in millions)

	Three Months Ended August 31, 1998			1997		
	Avg. Bal.	Rate %	Interest	Avg. Bal.	Rate %	Interest
Consumer loans	$34,076	15.19%	$1,305	$34,620	14.83%	$1,294
General purpose credit card loans	31,955	15.06%	1,212	32,283	14.73%	1,198
Total interest earning assets	36,034	14.71%	1,336	36,476	14.38%	1,322
Total interest bearing liabilities	31,640	6.13%	489	32,352	6.21%	507
Consumer loan interest rate spread		9.06%			8.62%	
Interest rate spread		8.58%			8.17%	
Net interest margin		9.32%			8.87%	

	Nine Months Ended August 31, 1998			1997		
	Avg. Bal.	Rate %	Interest	Avg. Bal.	Rate %	Interest
Consumer loans	$35,115	14.90%	$3,928	$34,393	14.84%	$3,831
General purpose credit card loans	32,887	14.75%	3,641	31,899	14.74%	3,529
Total interest earning assets	36,969	14.48%	4,019	36,050	14.44%	3,906
Total interest bearing liabilities	32,710	6.18%	1,518	32,126	6.15%	1,484
Consumer loan interest rate spread		8.72%			8.69%	
Interest rate spread		8.30%			8.29%	
Net interest margin		9.01%			8.95%	

Provision for Consumer Loan Losses

The provision for consumer loan losses is the amount necessary to establish the allowance for loan losses at a level the Company believes is adequate to absorb estimated losses in its consumer loan portfolio at the balance sheet date. The Company's allowance for loan losses is regularly evaluated by management for adequacy on a portfolio-by-portfolio basis and was $855 million and $868 million at August 31, 1998 and 1997. The provision for consumer loan losses, which is affected by net charge-offs, loan volume and changes in the amount of consumer loans estimated to be uncollectable, decreased 27% and 16% in the quarter and nine month period ended August 31, 1998 due to a decrease in net charge-offs. The decrease in net charge-offs in the quarter and nine month period ended August 31, 1998 was due to lower average levels of owned consumer loans, primarily attributable to an increased level of securitized loans, and a decrease in the rate of charge-offs primarily due to the sale of Prime Option. Net charge-offs as a percentage of average owned consumer loans outstanding decreased to 6.34% and 6.77% in the quarter and nine month period ended August 31, 1998 from 6.53% and 6.82% in the comparable periods of 1997. The Company continues to implement measures designed to improve the credit quality of both new and existing credit card accounts. The Company's expectations about future charge-off rates and credit quality are subject to uncertainties that could cause actual results to differ materially from what has been discussed above. Factors that influence the level and direction of consumer loan delinquencies and charge-offs include changes in consumer spending and payment behaviors, bankruptcy trends, the seasoning of the Company's loan portfolio, interest rate movements and their impact on consumer behavior, and the rate and magnitude of changes in the Company's consumer loan portfolio, including the overall mix of accounts, products and loan balances within the portfolio.

Consumer loans are considered delinquent when interest or principal payments become 30 days past due. Consumer loans are charged off when they become 180 days past due, except in the case of bankruptcies and fraudulent transactions, where loans are charged off earlier. Loan delinquencies and charge-offs are primarily affected by changes in economic conditions and may vary throughout the year due to seasonal consumer spending and payment behaviors.

From time to time, the Company has offered, and may continue to offer, cardmembers with accounts in good standing the opportunity to skip a minimum monthly payment, while continuing to accrue periodic finance charges, without being considered to be past due ("skip-a-payment"). The comparability of delinquency rates at any particular point in time may be affected depending on the timing of the skip-a-payment program. The delinquency rates for consumer loans 30-89 days past due at November 30, 1997 were favorably impacted by a skip-a-payment offer made in October 1997.

The following table presents delinquency and net charge-off rates with supplemental managed loan information. Information at August 31, 1998 includes the effects of the sale of Prime Option.

Asset Quality (dollars in millions)

	August 31,				November 30,	
	1998		1997		1997	
	Owned	Managed	Owned	Managed	Owned	Managed
Consumer loans at period-end	$17,658	$34,228	$21,493	$34,868	$20,917	$35,950
Consumer loans contractually past due as a Percentage of period-end consumer loans:						
30 to 89 days	4.15%	4.22%	4.50%	4.51%	3.96%	3.91%
90 to 179 days	2.95%	2.99%	2.96%	2.97%	3.11%	3.07%
Net charge-offs as a percentage of average consumer loans (year-to-date)	6.77%	6.89%	6.82%	6.86%	6.78%	6.95%

Non-Interest Expenses

Non-interest expenses increased 10% in the quarter ended August 31, 1998 and increased 3% in the nine month period ended August 31, 1998 from the comparable periods of 1997.

Compensation and benefits expense increased 7% in both the quarter and nine month period ended August 31, 1998 from the comparable periods of 1997 due to an increase in the number of employees. Occupancy and equipment expense increased 25% in the quarter and 22% in the nine month period ended August 31, 1998 primarily due to higher rent and other occupancy costs at certain of the Company's facilities. Brokerage, clearing and exchange fees relate to the trading activity associated with DBD. The increase in the nine month period ended August 31, 1998 was due to higher customer transaction volume as well as the inclusion of DBD's results for nine months in 1998 as compared to seven months in 1997. Information processing and communications expense increased 11% in the quarter ended August 31, 1998 and remained level in the nine month period ended August 31, 1998 from the comparable periods of 1997. The increase in the quarter ended August 31, 1998 was due to higher external data processing costs coupled with an adjustment resulting from the sale of the Company's indirect interest in one of the Company's transaction processing vendors in the third quarter of 1997. Marketing and business development expense increased 23% and 5% in the quarter and the nine month period ended August 31, 1998. The increases in both periods were due to higher advertising and promotional expenses associated with increased direct mail and other promotional activities related to the Discover® Card, partnership programs, and DBD, as well as higher cardmember rewards expense. These increases were partially offset by a decrease in promotional expenses resulting from the Company's discontinuance of the BRAVO® card and sale of Prime Option. The Company intends to continue its marketing program into the fourth quarter in order to focus on growing its consumer loan portfolio. Cardmember rewards expense includes the Cashback Bonus® award, pursuant to which the Company annually pays Discover Cardmembers and Private Issue® Cardmembers electing this feature a percentage of their purchase amounts. Commencing March 1, 1998, the terms of the Private Issue Cashback Bonus were amended by limiting the maximum annual bonus amount to $500 and by increasing the amount of purchases required to receive this bonus amount. The Company believes that its Cardmember rewards expense in future periods will not be materially impacted by these changes. Professional services expense increased 8% in the third quarter ended August 31, 1998 and 26% in the nine month period ended August 31, 1998 from the comparable periods of 1997. The increase in both periods was primarily due to increased costs associated with account collections and consumer credit counseling. Other expenses decreased 25% and 18% due to a continuing decrease in fraud losses and other general business expenses.

Liquidity and Capital Resources

The Company's total assets increased from $302.3 billion at November 30, 1997 to $360.9 billion at August 31, 1998, reflecting growth in securities borrowed, financial instruments owned and resale agreements, partially attributable to higher volumes in the global securities markets. A substantial portion of the Company's total assets consists of highly liquid marketable securities and short-term receivables arising principally from securities transactions. The highly liquid nature of these assets provides the Company with flexibility in financing and managing its business.

The Company's senior management establishes the overall funding and capital policies of the Company, reviews the Company's performance relative to these policies, monitors the availability of sources of financing, reviews the foreign exchange risk of the Company and oversees the liquidity and interest rate sensitivity of the Company's asset and liability position. The primary goal of the Company's funding and liquidity activities is to ensure adequate financing over a wide range of potential credit ratings and market environments.

The Company views return on equity to be an important measure of its performance, both in the context of the particular business environment in which the Company is operating and its peer group's results. In this regard, the Company actively manages its consolidated capital position based upon, among other things, business opportunities, capital availability and rates of return together with internal capital policies, regulatory requirements and rating agency guidelines and therefore may, in the future, expand or contract its capital base to address the changing needs of its businesses. The Company returns internally generated equity capital which is in excess of the needs of its businesses to its shareholders through common stock repurchases and dividends.

The Company funds its balance sheet on a global basis. The Company's funding for its Securities and Asset Management business is raised through diverse sources. These include the Company's capital, including equity and long-term debt; repurchase agreements; U.S., Canadian, Euro, French and Japanese commercial paper; letters of credit; unsecured bond borrows; German Schuldschein loans; securities lending; buy/sell agreements; municipal re-investments; master notes; and committed and uncommitted lines of credit. Repurchase transactions, securities lending and a portion of the Company's bank borrowings are made on a collateralized basis and therefore provide a more stable source of funding than short-term unsecured borrowings.

The funding sources utilized for the Company's Credit and Transaction Services business include the Company's capital, including equity and long-term debt; asset securitizations; commercial paper; deposits; asset-backed commercial paper; Fed Funds; and short-term bank notes. The Company sells consumer loans through asset securitizations using several transaction structures. Riverwoods Funding Corporation ("RFC"), an entity included in the condensed consolidated financial statements of the Company, issues asset-backed commercial paper.

The Company's bank subsidiaries solicit deposits from consumers, purchase federal funds and issue short-term bank notes. Interest bearing deposits are classified by type as savings, brokered and other time deposits. Savings deposits consist primarily of money market deposits and certificate of deposit accounts sold directly to cardmembers and savings deposits from individual securities clients. Brokered deposits consist primarily of certificates of deposits issued by the

Company's bank subsidiaries. Other time deposits include institutional certificates of deposits. The Company, through Greenwood Trust Company, an indirect subsidiary of the Company, sells notes under a short-term bank note program.

The Company maintains borrowing relationships with a broad range of banks, financial institutions, counterparties and others from which it draws funds in a variety of currencies. The volume of the Company's borrowings generally fluctuates in response to changes in the amount of repurchase transactions outstanding, the level of the Company's securities inventories and consumer loans receivable, and overall market conditions. Availability and cost of financing to the Company can vary depending upon market conditions, the volume of certain trading activities, the Company's credit ratings and the overall availability of credit.

The Company's reliance on external sources to finance a significant portion of its day-to-day operations makes access to global sources of financing important. The cost and availability of unsecured financing generally are dependent on the Company's short-term and long-term debt ratings. In addition, the Company's debt ratings have a significant impact on certain trading revenues, particularly in those businesses where longer term counterparty performance is critical, such as over-the-counter derivative transactions.

As of September 30, 1998, the Company's credit ratings were as follows:

	Commercial Paper	Senior Debt
Dominion Bond Rating Service Limited	R-1 (middle)	n/a
Duff & Phelps Credit Rating Co.	D-1 +	AA -
Fitch IBCA Inc.	F1 +	AA -
Japan Rating & Investment Information, Inc.	A-1 +	AA -
Moody's Investors Service(1)	P-1	A1
Standard & Poor's	A-1	A+
Thomson BankWatch, Inc.	TBW-1	AA

(1) On June 5, 1998, Moody's Investors Service announced that it had placed the Company's senior debt credit rating on review for possible upgrade.

As the Company continues its global expansion and as revenues are increasingly derived from various currencies, foreign currency management is a key element of the Company's financial policies. The Company benefits from operating in several different currencies because weakness in any particular currency is often offset by strength in another currency. The Company closely monitors its exposure to fluctuations in currencies and, where cost-justified, adopts strategies to reduce the impact of these fluctuations on the Company's financial performance. These strategies include engaging in various hedging activities to manage income and cash flows denominated in foreign currencies and using foreign currency borrowings, when appropriate, to finance investments outside the U.S.

During the nine month period ended August 31, 1998, the Company issued senior notes aggregating $9,301 million, including non-U.S. dollar currency notes aggregating $1,532 million, primarily pursuant to its public debt shelf registration statements. These notes have maturities from 1998 to 2024 and a weighted average coupon interest rate of 5.84% at August 31, 1998; the Company has entered into certain transactions to obtain floating interest rates based primarily on short-term LIBOR trading levels. At August 31, 1998, the aggregate outstanding principal amount of the Company's Senior Indebtedness (as defined in the Company's public debt shelf registration statements) was approximately $41.0 billion.

On February 12, 1998, the Company's Board of Directors authorized the Company to purchase, subject to market conditions and certain other factors, up to $3 billion of the Company's common stock. During the nine month period ended August 31, 1998 the Company purchased $2,049 million of its common stock. Subsequent to August 31, 1998 and through September 30, 1998, the Company purchased an additional $284 million of its common stock.

On February 25, 1998, the Company's shelf registration statement for an additional $8 billion of debt securities, warrants, preferred stock or purchase contracts or any combination thereof in the form of units, became effective.

On March 5, 1998, MSDW Capital Trust I, a Delaware statutory business trust (the "Capital Trust"), all of the common securities of which are owned by the Company, issued $400 million of 7.10% Capital Securities (the "Capital

Securities") that are guaranteed by the Company. The Capital Trust issued the Capital Securities and invested the proceeds in 7.10% Junior Subordinated Deferrable Interest Debentures issued by the Company, which are due February 28, 2038.

On August 31, 1998, the Company redeemed all 1,000,000 outstanding shares of its $7^{-3}/_{8}\%$ Cumulative Preferred Stock at a redemption price of $200 per share. The Company also simultaneously redeemed all corresponding Depositary Shares at a redemption price of $25 per Depositary Share. Each Depositary Share represented $^{1}/_{8}$ of a share of the Company's $7^{-3}/_{8}\%$ Cumulative Preferred Stock.

The Company maintains a senior revolving credit agreement with a group of banks to support general liquidity needs, including the issuance of commercial paper (the "MSDW Facility"). Under the terms of the MSDW Facility, the banks are committed to provide up to $6.0 billion. The MSDW Facility contains restrictive covenants which require, among other things, that the Company maintain shareholders' equity of at least $8.3 billion at all times. The Company believes that the covenant restrictions will not impair the Company's ability to pay its current level of dividends. At August 31, 1998, no borrowings were outstanding under the MSDW Facility.

The Company maintains a master collateral facility that enables Morgan Stanley & Co. Incorporated ("MS&Co."), one of the Company's U.S. broker-dealer subsidiaries, to pledge certain collateral to secure loan arrangements, letters of credit and other financial accommodations (the "MS&Co. Facility"). As part of the MS&Co. Facility, MS&Co. also maintains a secured committed credit agreement with a group of banks that are parties to the master collateral facility under which such banks are committed to provide up to $1.875 billion. At August 31, 1998, no borrowings were outstanding under the MS&Co. Facility.

The Company also maintains a revolving committed financing facility that enables Morgan Stanley & Co. International Limited ("MSIL"), the Company's U.K. broker-dealer subsidiary, to secure committed funding from a syndicate of banks by providing a broad range of collateral under repurchase agreements (the "MSIL Facility"). Such banks are committed to provide up to an aggregate of $1.85 billion available in 12 major currencies. At August 31, 1998, no borrowings were outstanding under the MSIL Facility.

RFC also maintains a $2.55 billion senior bank credit facility which supports the issuance of asset-backed commercial paper. RFC has never borrowed from its senior bank credit facility.

The Company anticipates that it will utilize the MSDW Facility, the MS&Co. Facility or the MSIL Facility for short-term funding from time to time.

At August 31, 1998, certain assets of the Company, such as real property, equipment and leasehold improvements of $1.8 billion, and goodwill and other intangible assets of $1.3 billion, were illiquid. In addition, certain equity investments made in connection with the Company's private equity and other principal investment activities, high-yield debt securities, emerging market debt, certain collateralized mortgage obligations and mortgage-related loan products, bridge financings, and certain senior secured loans and positions are not highly liquid.

In connection with its private equity and other principal investment activities, the Company has equity investments (directly or indirectly through funds managed by the Company) in privately and publicly held companies. At August 31, 1998, the aggregate carrying value of the Company's equity investments in privately held companies (including direct investments and partnership interests) was $153 million, and its aggregate investment in publicly held companies was $377 million.

In addition, at August 31, 1998, the aggregate value of high-yield debt securities and emerging market loans and securitized instruments held in inventory was $1,488 million (a substantial portion of which was subordinated debt). These securities, loans and instruments were not attributable to more than 4% to any one issuer, 22% to any one industry or 16% to any one geographic region. Non-investment grade securities generally involve greater risk than investment grade securities due to the lower credit ratings of the issuers, which typically have relatively high levels of indebtedness and are, therefore, more sensitive to adverse economic conditions. In addition, the market for non-investment grade securities and emerging market loans and securitized instruments has been, and may continue to be, characterized by periods of volatility and illiquidity. The Company has credit and other risk policies and procedures to control total inventory positions and risk concentrations for non-investment grade securities and emerging market loans and securitized instruments.

The Company acts as an underwriter of and as a market-maker in mortgage-backed pass-through securities, collateralized mortgage obligations and related instruments, and as a market-maker in commercial, residential and real estate loan products. In this capacity, the Company takes positions in market segments where liquidity can vary greatly from time to time. The carrying value of the portion of the Company's mortgage-related portfolio at August 31, 1998 traded in markets that the Company believed were experiencing lower levels of liquidity than traditional mortgage-backed pass-through securities approximated $2,265 million.

The Company may, from time to time, also provide financing or financing commitments to companies in connection with its investment banking and private equity activities. The Company may provide extensions of credit to leveraged companies in the form of senior or subordinated debt, as well as bridge financing on a selective basis (which may be in connection with the Company's commitment to the Morgan Stanley Bridge Fund, LLC). At August 31, 1998, the Company had six commitments to provide an aggregate of $350 million primarily in connection with its high-yield underwriting activities. At September 30, 1998, the Company had no loans outstanding, and its aggregate commitments increased to $370 million.

The Company also engages in senior lending activities, including origination, syndication and trading of senior secured loans of non-investment grade companies. Such companies are more sensitive to adverse economic conditions than investment grade issuers, but the loans are generally made on a secured basis and are senior to any non-investment grade securities of these issuers that trade in the capital markets. At August 31, 1998, the aggregate value of senior secured loans and positions held by the Company was $1,233 million, and aggregate senior secured loan commitments were $577 million.

During the month of August, 1998 and continuing in the fourth quarter of fiscal 1998, inventories of certain credit sensitive fixed income securities (e.g., certain investment grade, high yield and securitized securities) experienced a decrease in liquidity. The Company continues to manage the risks associated with these inventories, including market, credit and concentration risks, in a manner consistent with the Company's overall risk management policies and procedures (see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management" and Note 8 to the consolidated financial statements for the fiscal year ended November 30, 1997, included in the Form 10-K).

In September 1998, the Company made an investment of $300 million in the Long-Term Capital Portfolio, L.P. ("LTCP"). The Company is a member of a consortium of 14 financial institutions participating in an equity recapitalization of LTCP. The objectives of this investment, the term of which is three years, are to continue active management of its positions and, over time, to reduce excessive risk exposures and leverage, return capital to the participants and ultimately realize the potential value of the LTCP portfolio.

At August 31, 1998, financial instruments owned by the Company included derivative products (generally in the form of futures, forwards, swaps, caps, collars, floors, swap options and similar instruments which derive their value from underlying interest rates, foreign exchange rates or commodity or equity instruments and indices) related to financial instruments and commodities with an aggregate net replacement cost of $22.5 billion. The net replacement cost of all derivative products in a gain position represents the Company's maximum exposure to derivatives related credit risk. Derivative products may have both on- and off-balance sheet risk implications, depending on the nature of the contract. It should be noted, however, that in many cases derivatives serve to reduce, rather than increase, the Company's exposure to losses from market, credit and other risks. The risks associated with the Company's derivative activities, including market and credit risks, are managed on an integrated basis with associated cash instruments in a manner consistent with the Company's overall risk management policies and procedures. The Company manages its credit exposure to derivative products through various means, which include reviewing counterparty financial soundness periodically; entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances; and limiting the duration of exposure.

Preparation for the Year 2000 and EMU

Year 2000

Many of the world's computer systems (including those in non-information technology equipment and systems) currently record years in a two-digit format. If not addressed, such computer systems will be unable to properly interpret dates beyond the year 1999, which could lead to business disruptions in the U.S. and internationally (the "Year 2000" issue). The potential costs and uncertainties associated with the Year 2000 issue will depend on a number of factors, including software, hardware and the nature of the industry in which a company operates. Additionally, companies must coordinate with other entities with which they electronically interact.

The Company has established a firm-wide initiative to address issues associated with the Year 2000. The Year 2000 and EMU (discussed below) projects have been designated as the highest priority activities of the Company's Information Technology Department. To ensure that the Company's computer systems are Year 2000 compliant, a team of Information Technology professionals began preparing for the Year 2000 issue in 1995. Since then, the Company has been reviewing its systems and programs to identify those that contain two-digit year codes, and is in the process of upgrading its global infrastructure and corporate facilities to achieve Year 2000 compliance. In addition, the Company is actively working with its major external counterparties and suppliers to assess their compliance and remediation efforts and the Company's exposure to them.

In addressing the Year 2000 issue, the Company has identified the following phases. In the *Awareness phase*, the Company defined the Year 2000 issue and obtained executive level support and funding. In the *Inventory phase*, the Company collected a comprehensive list of items that may be affected by Year 2000 compliance issues. Such items include facilities and related non-information technology systems (embedded technology), computer systems, hardware, and services and products provided by third parties. In the *Assessment phase*, the Company evaluated the items identified in the *Inventory phase* to determine which will function properly with the change to the new century, and ranked items which will need to be remediated based on their potential impact to the Company. The *Remediation phase* includes an analysis of the items that are affected by Year 2000, the identification of problem areas and the repair of non-compliant items. The *Testing phase* includes a thorough testing of all proposed repairs, including present and forward date testing which simulates dates in the Year 2000. The *Implementation phase* consists of placing all items that have been remediated and successfully tested into production. Finally, the *Integration and External Testing phase* includes exercising business critical production systems in a future time environment and testing with external entities.

As of August 31, 1998, the Company had completed the Awareness, Inventory and Assessment phases. As of August 31, 1998, the Company was also conducting the procedures associated with the Remediation, Testing and Implementation phases. The Company expects to complete the Remediation and Testing phases with respect to its mission critical applications by December 1998, with the Implementation phase completed by the first fiscal quarter of 1999. The Integration and External Testing phase commenced in the second quarter of 1998 and will continue through 1999. In addition, the major business relationships of the Company have been identified and many of them are scheduled to be tested. The Company continues to survey and communicate with counterparties, intermediaries and vendors with whom it has important financial and operational relationships to determine the extent to which they are vulnerable to Year 2000 issues. As of August 31, 1998, the Company has not yet received sufficient information from all parties about their remediation plans to predict the outcomes of their efforts. In particular, in some international markets in which the Company conducts business, the level of awareness and remediation efforts relating to the Year 2000 issue is thought to be less advanced than in the United States.

During the third quarter, the Company participated in the Securities Industry Association's Beta test and a test sponsored by the Bank of England's Central Gilts Office. These tests were run in "future time", using a portion of the Company's production system and employed test scripts to check functionality. The Company has achieved successful results in each of the industry-wide tests in which it participated. During the remainder of 1998 and 1999, the Company will continue to participate in industry-wide and vendor specific tests.

There are many risks associated with the Year 2000 issue, including the possibility of a failure of the Company's computer and non-information technology systems. Such failures could have a material adverse effect on the Company and may cause systems malfunctions, incorrect or incomplete transaction processing resulting in failed trade settlements, the inability to reconcile accounting books and records, the inability to reconcile trading positions and balances with counterparties, inaccurate information to manage the Company's exposure to trading risks and disruptions of funding requirements. In addition, even if the Company successfully remediates its Year 2000 issues, it can be materially and adversely affected by failures of third parties to remediate their own Year 2000 issues. The failure of third parties with which the Company has financial or operational relationships such as securities exchanges, clearing organizations, depositories, regulatory agencies, banks, clients, counterparties, vendors and utilities, to remediate their computer and non-information technology systems issues in a timely manner could result in a material financial risk to the Company.

If the above mentioned risks are not remedied, the Company may experience business interruption or shutdown, financial loss, regulatory actions, damage to the Company's global franchise and legal liability.

The Company has business continuity plans in place that cover its current worldwide operations, and Year 2000 specific contingency planning has begun. The Company intends to document Year 2000 specific contingency plans during 1999 as part of its Year 2000 risk mitigation efforts.

Based upon current information, the Company estimates that the total cost of implementing its Year 2000 initiative will be between $225 and $250 million. The Year 2000 costs include all activities undertaken on Year 2000 related matters across the Company, including, but not limited to, remediation, testing (internal and external), third party review, risk mitigation and contingency planning. Through the third quarter of fiscal 1998 the Company has expended approximately $117 million on the Year 2000 project. The majority of the remaining costs are expected to be directed primarily towards testing activities. These costs have been and will continue to be funded through operating cash flow and are expensed in the period in which they are incurred.

The Company's expectations about future costs and the timely completion of its Year 2000 modifications are subject to uncertainties that could cause actual results to differ materially from what has been discussed above. Factors that could influence the amount of future costs and the effective timing of remediation efforts include the success of the Company in identifying computer programs and non-information technology systems that contain two-digit year codes, the nature and amount of programming and testing required to upgrade or replace each of the affected programs and systems, the nature and amount of testing, verification and reporting required by the Company's regulators around the world, including securities exchanges, central banks and various governmental regulatory bodies, the rate and magnitude of related labor and consulting costs, and the success of the Company's external counterparties and suppliers, as well as worldwide exchanges, clearing organizations and depositories, in addressing the Year 2000 issue.

EMU

EMU replaces the national currencies of 11 participating European Union countries with a single European currency — the "Euro." This new currency is expected to be launched on January 1, 1999, when the European Central Bank assumes control of monetary policy for the participating nations. During a three-year transition period, the national currencies would continue to exist but only as fixed denominations of the Euro. EMU will primarily impact the Company's Securities and Asset Management businesses.

The introduction of the Euro presents major business opportunities for financial market participants such as the Company as well as significant challenges for such participants to be prepared for EMU. The Company expects that the introduction of the Euro will lead to greater cross-border price transparency and will have a significant impact on the markets in which the Company operates.

The Company has been actively preparing for the introduction of the Euro and is in the process of implementing significant modifications to its information technology systems and programs in order to prepare for transition to the Euro. The Company is engaged in extensive testing of the systems and processes affected by EMU. The testing plan is currently on schedule for completion. The Company is also communicating extensively with its clients and counterparties regarding the implications of EMU and the effect that this will have on their business relationships with the Company. The Company expects to be prepared for EMU by the end of the fourth quarter of fiscal 1998.

Several operating risks are associated with changes of this magnitude. If not properly implemented, these changes could lead to failed trade settlements, the inability to reconcile trading positions and balances with third parties, and funding disruptions. The Company is also dependent on the successful implementation of conversion procedures by market counterparties such as exchanges, clearing agents and information providers. If these third party systems do not appropriately address the introduction of the Euro, the Company’s clearance, settlement and other activities could also be adversely impacted.

Based upon current information, the Company estimates that the costs associated with reviewing and amending its information technology systems to prepare for EMU for fiscal 1998 and through the project’s completion will be approximately $70 million. These costs have been and will continue to be funded through operating cash flow and are expensed in the period in which they are incurred.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings.

(a) The following matters were recently commenced against the Company.

Friedman, et al. v. Salomon Smith Barney, Inc., et al. On or about August 21, 1998, a purported class action complaint was filed in the United States District Court for the Southern District of New York against Salomon Smith Barney, Inc., Goldman Sachs, Merrill Lynch & Co., Inc., Credit Suisse First Boston, Inc., Morgan Stanley Dean Witter & Co., Paine Webber Inc., Natwest Securities, BT Alex Brown, Inc., Coburn & Meredith, and Shamrock Partners Ltd. The plaintiff class purports to consist of all individuals who purchased shares of public offerings from defendants and their alleged co-conspirators and who were discouraged from selling those shares prior to the expiration of the penalty bid period of an offering. The complaint alleges that defendants engaged in anticompetitive activity with respect to the sale and distribution of public offerings of securities by agreeing to fix, raise, stabilize and maintain the price of shares of public offerings at levels above free market prices through a pattern and practice of discouraging the "flipping" or sale of shares by customers and/or penalizing or otherwise preventing "flipping" by customers. The complaint alleges violations of Section 1 of the Sherman Act and breach of fiduciary duty, and seeks compensatory and treble damages in unspecified amounts, injunctive relief, costs and expenses, including attorneys', accountants' and experts' fees.

Another purported class action, captioned *Myers v. Merrill Lynch & Co., Inc. et al.,* was filed on or about August 17, 1998 in California Superior Court, San Francisco County, against Merrill Lynch & Co., Inc., Paine Webber Group Incorporated, Morgan Stanley Dean Witter & Co., Travelers Group Inc., Legg Mason Inc., H.J. Meyers & Co., Inc. and The Bear Stearns Companies Inc. The complaint alleges that defendants sold the stock of public companies to investors in public offerings without disclosing the existence of restrictions on "flipping" and purported conflicts of interest with investors resulting from financial and other penalties imposed on brokers and clients for "flipping." The complaint also alleges that similar restrictions were not imposed on larger institutional purchasers of stock in those offerings. The complaint asserts claims for unfair competition and false advertising under various sections of the California Business and Professions Code, negligent misrepresentations under the California Civil Code and unfair, fraudulent and unlawful business practices under the California Business Code. The complaint seeks injunctive relief and an award of costs and expenses, including attorneys' and experts' fees. On September 15, 1998, the action was removed to the United States District Court for the Northern District of California.

(b) The following developments have occurred with respect to certain matters previously reported in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 1997 and/or the Company's Quarterly Reports on Form 10-Q for the quarters ended February 28, 1998 and May 31, 1998.

Department of Justice NASDAQ Investigation. On August 6, 1998, the United States Court of Appeals for the Second Circuit affirmed the Order and Stipulation, rejecting the intervenors' contention that it was impermissible to insulate the telephone tapes from discovery in civil litigation.

Global Opportunity Fund Litigation. On July 2, 1998, the United States District Court for the Southern District of New York granted The Growth Fund's motion to remand its lawsuit against Morgan Stanley & Co. International Limited ("MSIL") to state court. On July 2, 1998, MSIL filed a motion to dismiss the action.

County of Orange and Moorlach v. Morgan Stanley & Co., Inc. On July 21, 1998, the Company agreed to settle with Orange County. The agreement is subject to court approval, and the County has filed motions seeking determinations that its existing settlements are fair.

In re Merrill Lynch, et al., Securities Litigation. On July 21, 1998, the Magistrate granted the plaintiff's motion to file an amended complaint. Defendants have appealed that ruling to the district court judge.

In re Sumitomo Copper Litigation. On July 22, 1998, Morgan Stanley & Co. Incorporated entered into an agreement to settle the litigation. The settlement agreement is subject to court approval.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

An exhibit index has been filed as part of this Report on Page E-1.

(b) Reports on Form 8-K

Form 8-K dated June 18, 1998 reporting Item 5 and 7.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MORGAN STANLEY DEAN WITTER & CO.
(Registrant)

/S/ EILEEN K. MURRAY

By:____
Eileen K. Murray, Controller and
Principal Accounting Officer

Date: October 14, 1998

EXHIBIT INDEX

MORGAN STANLEY DEAN WITTER & CO.

Quarter Ended August 31, 1998

	Description
3	Amended and Restated Bylaws.
10.1	Dean Witter Reynolds Inc. Branch Manager Compensation Plan , Amended and Restated as of September 25, 1998.
10.2	Dean Witter Reynolds Inc. Financial Advisor Productivity Compensation Plan, Amended and Restated as of September 25, 1998.
11	Computation of earnings per share.
12	Computation of ratio of earnings to fixed charges.
15.1	Letter of awareness from Deloitte & Touche LLP, dated October 14, 1998, concerning unaudited interim financial information.
15.2	Letter of awareness from Ernst & Young LLP, dated October 14, 1998, concerning unaudited interim financial information.
27	Financial Data Schedule.