

NOTES TO 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 consolidated financial statements include the accounts of the Company 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. (formerly known as Dean Witter InterCapital 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 securities lending. The Company's Credit and Transaction Services businesses include the issuance of the Discover® Card and other proprietary general purpose credit cards, the operation of the Discover/NOVUS® Network, a proprietary

network of merchant and cash access locations, and direct-marketed activities such as the online securities services offered by Discover Brokerage Direct, Inc. 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

The 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. The consolidated statement of changes in shareholders' equity reflects the accounts of the Company as if the preferred and additional common stock had been issued during all of the periods presented.

Prior to the consummation of 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. In recording the pooling of interests combination, Dean Witter Discover's financial statements for the year ended December 31, 1996 were combined with Morgan Stanley's financial statements for the fiscal year ended November 30, 1996 (on a combined basis, "fiscal 1996"). The Company's results for the 12 months ended November 30, 1998 ("fiscal 1998") and November 30, 1997 ("fiscal 1997") reflect the change in fiscal year-end. Fiscal 1997 includes the results of Dean Witter Discover that were restated to conform with the new fiscal year-end date. The Company's results of operations for fiscal 1997 and fiscal 1996 include the month of December 1996 for Dean Witter Discover.

The 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 consolidated financial statements and related disclosures. Management believes that the estimates utilized in the preparation of the con-

solidated 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 inter-company balances and transactions have been eliminated.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For purposes of these statements, cash and cash equivalents consist of cash and highly liquid investments not held for resale with maturities, when purchased, of three months or less.

In connection with the fiscal 1997 purchase of Discover Brokerage Direct, Inc. (formerly Lombard Brokerage, Inc.), the Company issued 1.9 million shares of common stock having a fair value on the date of acquisition of approximately \$63 million. In connection with the purchase of Miller Anderson & Sherrerd, LLP ("MAS") in fiscal 1996, the Company issued approximately \$66 million of notes payable, as well as 3.3 million shares of common stock having a fair value on the date of acquisition of approximately \$83 million. In addition, in connection with the purchase in fiscal 1996 of VK/AC Holding, Inc., the parent of Van Kampen American Capital, Inc., the Company assumed approximately \$162 million of long-term debt.

CONSUMER LOANS

Consumer loans, which consist primarily of credit card and other consumer installment loans, are reported at their principal amounts outstanding, less applicable allowances. Interest on consumer loans is credited to income as earned.

Interest is accrued on credit card loans until the date of charge-off, which generally occurs at the end of the month during which an account becomes 180 days past due, except in the case of bankruptcies and fraudulent transactions, which are charged off earlier. The interest portion of charged-off credit card loans is writ-

ten off against interest revenue. Origination costs related to the issuance of credit cards are charged to earnings over periods not exceeding 12 months.

ALLOWANCE FOR CONSUMER LOAN LOSSES

The allowance for consumer loan losses is a significant estimate that is regularly evaluated by management for adequacy on a portfolio-by-portfolio basis and is established through a charge to the provision for loan losses. The evaluations take into consideration factors such as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrower's ability to pay.

The Company uses the results of these evaluations to provide an allowance for loan losses. The exposure for credit losses for owned loans is influenced by the performance of the portfolio and other factors discussed above, with the Company absorbing all related losses. The exposure for credit losses for securitized loans is represented by the Company retaining a contingent risk based on the amount of credit enhancement provided.

SECURITIZATION OF CONSUMER LOANS

The Company periodically sells consumer loans through asset securitizations and continues to service these loans. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS No. 125"), the present value of the future net servicing revenues which the Company estimates that it will receive over the term of the securitized loans is recognized in income as the loans are securitized. A corresponding asset also is recorded and then amortized as a charge to income over the term of the securitized loans, with actual net servicing revenues continuing to be recognized in income as they are earned. The impact of recognizing the present value of estimated future net servicing revenues as loans are securitized has not been material to the consolidated statements of income.

FINANCIAL INSTRUMENTS USED FOR TRADING AND INVESTMENT

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 and dividend revenue and interest expense arising from financial instruments used in trading activities are reflected in the consolidated statements of income as interest and dividend revenue or interest expense. The fair values of the 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 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 initially are carried in the 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.

FINANCIAL INSTRUMENTS USED FOR ASSET AND LIABILITY MANAGEMENT

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 and foreign currency swaps. The Company uses interest rate and currency swaps to manage the interest rate and currency exposure arising from certain borrowings and to match the repricing characteristics of consumer loans with those of 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.

SECURITIES TRANSACTIONS

Clients' securities transactions are recorded on a settlement date basis with related commission revenues and expenses recorded on trade date. Securities purchased under agreements to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements), principally government and

agency securities, are treated as financing transactions and are carried at the amounts at which the securities subsequently will be resold or reacquired as specified in the respective agreements; such amounts include accrued interest. Reverse repurchase and repurchase agreements are presented on a net-by-counterparty basis, when appropriate. It is the Company's policy to take possession of securities purchased under agreements to resell. The Company monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral. Where deemed appropriate, the Company's agreements with third parties specify its rights to request additional collateral.

Securities borrowed and securities loaned are carried at the amounts of cash collateral advanced and received in connection with the transactions. The Company measures the fair value of the securities borrowed and loaned against the collateral on a daily basis. Additional collateral is obtained as necessary to ensure such transactions are adequately collateralized.

INVESTMENT BANKING

Underwriting revenues and fees for mergers and acquisitions and advisory assignments are recorded when services for the transaction are substantially completed. Transaction-related expenses are deferred and later expensed to match revenue recognition.

OFFICE FACILITIES

Office facilities are stated at cost less accumulated depreciation and amortization. Depreciation and amortization of buildings and leasehold improvements are provided principally by the straight-line method, while depreciation and amortization of furniture, fixtures and equipment are provided by both straight-line and accelerated methods. Property and equipment are depreciated over the estimated useful lives of the related assets, while leasehold improvements are amortized over the lesser of the economic useful life of the asset or, where applicable, the remaining term of the lease.

INCOME TAXES

Income tax expense is provided for using the asset and liability method, under which deferred tax assets and liabilities are determined based upon the temporary differences between the financial statement and income tax bases of assets and liabilities, using currently enacted tax rates.

EARNINGS PER SHARE

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.

As of December 1, 1997, the Company adopted 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.

CARDMEMBER REWARDS

Cardmember rewards, primarily the Cashback Bonus® award, pursuant to which the Company annually pays Discover Cardmembers and Private Issue® Cardmembers a percentage of their purchase amounts ranging up to 1% (up to 2% for the Private Issue Card), are based upon a cardmember's level of annual purchases. The liability for cardmember rewards expense, included in other liabilities and accrued expenses, is accrued at the time that qualified cardmember transactions occur and is calculated on an individual cardmember basis.

STOCK-BASED COMPENSATION

SFAS No. 123, "Accounting for Stock-Based Compensation" encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has elected to continue to account for its stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"). Under the provisions of APB No. 25, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's common stock at the date of grant over the amount an employee must pay to acquire the stock.

TRANSLATION OF FOREIGN CURRENCIES

Assets and liabilities of operations having non-U.S. dollar functional currencies are translated at year-end rates of exchange, and the income statements are translated at weighted average rates of exchange for the year. In accordance with SFAS No. 52, "Foreign Currency Translation," gains or losses resulting from translating foreign currency financial statements, net of hedge gains or losses and related tax effects, are reflected in cumulative translation adjustments, a separate component of shareholders' equity. Gains or losses resulting from foreign currency transactions are included in net income.

GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets are amortized on a straight-line basis over periods from five to 40 years, generally not exceeding 25 years, and are periodically evaluated for impairment. At November 30, 1998, goodwill of approximately \$1.2 billion was included in the Company's consolidated statements of financial condition as a component of Other Assets.

ACCOUNTING CHANGE

In the fourth quarter of fiscal 1998, the Company adopted American Institute of Certified Public Accountants ("AICPA") Statement of Position 98-5, "Reporting on the Costs of Start-Up Activities" ("SOP

98-5"), with respect to the accounting for offering costs paid by investment advisors of closed-end funds where such costs are not specifically reimbursed through separate advisory contracts. In accordance with SOP 98-5 and per an announcement by the Financial Accounting Standards Board ("FASB") staff in September 1998, such costs are to be considered start-up costs and expensed as incurred. Prior to the adoption of SOP 98-5, the Company deferred such costs and amortized them over the life of the fund. The Company recorded a charge to earnings for the cumulative effect of the accounting change as of December 1, 1997, of \$117 million, net of taxes of \$79 million. The first three quarters of fiscal 1998 have been retroactively restated to reflect this change (see Note 18). The effect of adopting these provisions on the Company's income before the cumulative effect of the accounting change for fiscal year 1998 was a decrease of \$24 million, net of taxes. The effect on diluted and basic earnings per share was \$0.04. The pro forma effect on net income for fiscal years 1997 and 1996 would not have been material.

NEW ACCOUNTING PRONOUNCEMENTS

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 required the recognition of assets and liabilities on the Company's consolidated statement of financial condition related to certain securities provided and received as collateral. At November 30, 1998, the Company recorded an obligation to return securities received as collateral of \$6,636 million. The related collateral assets were recorded among various captions included in the Company's consolidated statement of financial condition. After giving effect to reclassifications, the net increase in total assets and total liabilities was \$2,089 million.

In June 1997, the 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.

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 generally accounted for in a manner similar to treasury stock. The Company therefore has included its obligations under certain deferred compensation plans in employee stock trust. Shares that the Company has issued to the rabbi trusts are recorded in common stock issued to employee trust. Both employee stock trust and common stock issued to employee trust are components of shareholders' equity. The adoption of EITF 97-14 did not result in any change to the Company's consolidated statement of income, total assets, total liabilities or total shareholders' equity.

3 CONSUMER LOANS

Consumer loans were as follows:

(dollars in millions)	NOV. 30, 1998	NOV. 30, 1997
Credit card	\$15,993	\$20,914
Other consumer installment	3	3
	15,996	20,917
Less:		
Allowance for loan losses	787	884
Consumer loans, net	\$15,209	\$20,033

Activity in the allowance for consumer loan losses was as follows:

(dollars in millions)	FISCAL 1998	fiscal 1997	fiscal 1996
Balance beginning of period	\$ 884	\$ 781 ⁽²⁾	\$ 709
Additions:			
Provision for loan losses	1,173	1,493	1,214
Purchase of loan portfolios	1	—	4
Total additions	1,174	1,493	1,218
Deductions:			
Charge-offs	1,423	1,639	1,182
Recoveries	(170)	(196)	(155)
Net charge-offs	1,253	1,443	1,027
Other ⁽¹⁾	(18)	53	(98)
Balance end of period	\$ 787	\$ 884	\$ 802

(1) These amounts primarily reflect net transfers related to asset securitizations and the sale of consumer loans associated with SPS, Prime Option and BRAVO (see Note 17).

(2) Beginning balance differs from the fiscal 1996 end-of-period balance due to the Company's change in fiscal year-end.

Interest accrued on loans subsequently charged off, recorded as a reduction of interest revenue, was \$199 million, \$301 million and \$181 million in fiscal 1998, 1997 and 1996, respectively. The amounts charged off in fiscal 1998 include only interest, whereas amounts in fiscal 1997 and 1996 also include cardmember fees.

At November 30, 1998 and 1997, \$3,999 million and \$5,385 million of the Company's consumer loans had minimum contractual maturities of less than one year. Because of the uncertainty

regarding consumer loan repayment patterns, which historically have been higher than contractually required minimum payments, this amount may not necessarily be indicative of the Company's actual consumer loan repayments.

At November 30, 1998, the Company had commitments to extend credit in the amount of \$170.5 billion. Commitments to extend credit arise from agreements to extend to customers unused lines of credit on certain credit cards provided there is no violation of conditions established in the related agreement. These commitments, substantially all of which the Company can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage and customer creditworthiness.

The Company received proceeds from asset securitizations of \$4,466 million, \$2,783 million and \$4,528 million in fiscal 1998, 1997 and 1996, respectively. The uncollected balances of consumer loans sold through asset securitizations were \$16,506 million and \$15,033 million at November 30, 1998 and 1997.

The Company uses interest rate exchange agreements to hedge the risk from changes in interest rates on servicing fee revenues (which are derived from loans sold through asset securitizations). Gains and losses from these agreements are recognized as adjustments to servicing fees.

The estimated fair value of the Company's consumer loans approximated carrying value at November 30, 1998 and 1997. The Company's consumer loan portfolio, including securitized loans, is geographically diverse, with a distribution approximating that of the population of the United States.

4 DEPOSITS

Deposits were as follows:

(dollars in millions)	NOV. 30, 1998	NOV. 30, 1997
Demand, passbook and money market accounts	\$1,355	\$1,210
Consumer certificate accounts	1,635	1,498
\$100,000 minimum certificate accounts	5,207	6,285
Total	\$8,197	\$8,993

The weighted average interest rates of interest bearing deposits outstanding during fiscal 1998 and 1997 were 6.2%.

At November 30, 1998 and 1997, the notional amounts of interest rate exchange agreements that hedged deposits outstanding were \$650 million and \$535 million and had fair values of \$15 million and \$7 million. Under these interest rate exchange agreements, the Company primarily pays floating rates and receives fixed rates. At November 30, 1998, the weighted average interest rate of the Company's deposits, including the effect of interest rate exchange agreements, was 6.1%.

At November 30, 1998, certificate accounts maturing over the next five years were as follows:

(dollars in millions)	
1999	\$2,448
2000	1,502
2001	1,261
2002	592
2003	620

The estimated fair value of the Company's deposits, using current rates for deposits with similar maturities, approximated carrying value at November 30, 1998 and 1997.

5 SHORT-TERM BORROWINGS

At November 30, 1998 and 1997, commercial paper in the amount of \$19,643 million and \$15,447 million, with weighted average interest rates of 5.3% and 5.5%, was outstanding.

At November 30, 1998 and 1997, the notional amounts of interest rate contracts that hedged commercial paper outstanding were \$208 million and \$732 million and had fair values of \$(6) million and \$(5) million. These interest rate contracts effectively converted the commercial paper to fixed rates. These contracts had no material effect on the weighted average interest rates of commercial paper.

At November 30, 1998 and 1997, other short-term borrowings of \$8,494 million and \$7,167 million were outstanding. These borrowings included bank loans, Federal Funds and bank notes.

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 \$9.1 billion at all times. The Company believes that the covenant restrictions will not impair the Company'

MEDIUM-TERM NOTES

Included in the table above are medium-term notes of \$17,011 million and \$14,049 million at November 30, 1998 and 1997. The effective weighted average interest rate on all medium-term notes was 5.7% in fiscal 1998 and 5.9% in fiscal 1997. Maturities of these notes range from fiscal 1999 through fiscal 2028.

STRUCTURED BORROWINGS

U.S. dollar index/equity linked borrowings include various structured instruments whose payments and redemption values are linked to the performance of a specific index (i.e., Standard & Poor's 500), a basket of stocks or a specific equity security. To minimize the exposure resulting from movements in the underlying equity position or index, the Company has entered into various equity swap contracts and purchased options which effectively convert the borrowing costs into floating rates based upon LIBOR. These instruments are included in the preceding table at their redemption values based on the performance of the underlying indices, baskets of stocks or specific equity securities at November 30, 1998 and 1997.

OTHER BORROWINGS

Included in the Company's long-term borrowings are subordinated notes of \$1,309 million and \$1,302 million at November 30, 1998 and 1997, respectively. The effective weighted average interest rate on these subordinated notes was 7.1% in fiscal 1998 and 7.2% in fiscal 1997. Maturities of the subordinated notes range from fiscal 1999 to fiscal 2016.

Certain of the Company's long-term borrowings are redeemable prior to maturity at the option of the holder. These notes contain certain provisions which effectively enable noteholders to put the notes back to the Company and therefore are scheduled in the foregoing table to mature in fiscal 1999 through fiscal 2001. The stated maturities of these notes, which aggregate \$1,933 million, are from fiscal 2000 to fiscal 2011.

MS&Co., a registered U.S. broker-dealer subsidiary of the Company, has outstanding \$357 million of 8.22% fixed rate subordinated Series A notes, \$243 million of 8.51% fixed rate subor-

dinated Series B notes, \$313 million of 6.81% fixed rate subordinated Series C notes, \$96 million of 7.03% fixed rate subordinated Series D notes, \$82 million of 7.28% fixed rate subordinated Series E notes and \$25 million of 7.82% fixed rate subordinated Series F notes. These notes have maturities from 2001 to 2016. The terms of such notes contain restrictive covenants which require, among other things, that MS&Co. maintain specified levels of Consolidated Tangible Net Worth and Net Capital, each as defined.

ASSET AND LIABILITY MANAGEMENT

A portion of the Company's fixed rate long-term borrowings is used to fund highly liquid marketable securities, short-term receivables arising from securities transactions and consumer loans. The Company uses interest rate swaps to more closely match the duration of these borrowings to the duration of the assets being funded and to minimize interest rate risk. These swaps effectively convert certain of the Company's fixed rate borrowings into floating rate obligations. In addition, for non-U.S. dollar currency borrowings that are not used to fund assets in the same currency, the Company has entered into currency swaps which effectively convert the borrowings into U.S. dollar obligations. The Company's use of swaps for asset and liability management reduced its interest expense and effective average borrowing rate as follows:

(dollars in millions)	FISCAL 1998	fiscal 1997	fiscal 1996
Net reduction in interest expense from swaps for the fiscal year	\$48	\$21	\$29
Weighted average coupon of long-term borrowings at fiscal year-end ⁽¹⁾	6.1%	6.1%	6.2%
Effective average borrowing rate for long-term borrowings after swaps at fiscal year-end ⁽¹⁾	5.9%	6.0%	6.1%

(1) Included in the weighted average and effective average calculations are non-U.S. dollar interest rates.

The effective weighted average interest rate on the Company's index/equity linked notes, which is not included in the table above, was 5.2% and 5.7% in fiscal 1998 and fiscal 1997, respectively, after giving effect to the related hedges.

The table below summarizes the notional or contract amounts of these swaps by maturity and weighted average interest rates to be received and paid at fiscal year-end 1998. Swaps utilized to hedge the Company's structured borrowings are presented at their redemption values:

(dollars in millions)	U.S. DOLLAR				NON-U.S. DOLLAR ⁽¹⁾			NOV. 30, 1998 TOTAL	NOV. 30, 1997 TOTAL
	Receive Fixed Pay Floating	Receive Floating Pay Fixed	Receive Floating Pay Floating	Index/ Equity Linked	Receive Fixed Pay Floating	Receive Floating Pay Floating ⁽²⁾			
Maturing in fiscal 1998	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 2,744
Maturing in fiscal 1999	552	100	375	587	195	372	2,181	1,972	
Maturing in fiscal 2000	1,169	400	20	347	62	243	2,241	638	
Maturing in fiscal 2001	1,384	80	5	88	110	514	2,181	1,082	
Maturing in fiscal 2002	720	200	—	42	17	—	979	831	
Maturing in fiscal 2003	500	—	—	105	428	219	1,252	1,029	
Thereafter	3,020	400	—	217	620	10	4,267	3,411	
Total	\$ 7,345	\$1,180	\$400	\$1,386	\$1,432	\$1,358	\$13,101	\$11,707	
Weighted average at fiscal year-end⁽³⁾									
Receive rate	6.53%	5.25%	4.88%	n/a	5.24%	4.77%			
Pay rate	5.59%	6.22%	5.65%	n/a	4.94%	5.44%			

(1) The differences between the receive rate and the pay rate may reflect differences in the rate of interest associated with the underlying currency.

(2) These amounts include currency swaps used to effectively convert borrowings denominated in one currency into obligations denominated in another currency.

(3) The table was prepared under the assumption that interest rates remain constant at year-end levels. The variable interest rates to be received or paid will change to the extent that rates fluctuate. Such changes may be substantial. Variable rates presented generally are based on LIBOR or Treasury bill rates.

As noted above, the Company uses interest rate and currency swaps to modify the terms of its existing borrowings. Activity during the periods in the notional value of the swap contracts used by the Company for asset and liability management (and the unrecognized gain at fiscal year-end) is summarized in the table below:

(dollars in millions)	FISCAL 1998	fiscal 1997
Notional value at beginning of period	\$11,707	\$10,189
Additions	4,520	3,567
Matured	(2,305)	(1,657)
Terminated	(868)	(216)
Effect of foreign currency translation on non-U.S. dollar notional values and changes in redemption values on structured borrowings	47	(176)
Notional value at fiscal year-end	<b style="text-align: right;">\$13,101	<b style="text-align: right;">\$11,707
Unrecognized gain at fiscal year-end	\$ 279	\$ 104

The Company also uses interest rate swaps to modify certain of its repurchase financing agreements. The Company had interest rate swaps with notional values of approximately \$1.3 billion and \$1.8 billion at November 30, 1998 and 1997, and unrecognized gains of approximately \$28 million and \$13 million at November 30, 1998 and 1997, for such purpose. The unrecognized gains on these swaps were offset by unrecognized losses on certain of the Company's repurchase financing agreements.

The estimated fair value of the Company's long-term borrowings approximated carrying value based on rates available to the Company at year-end for borrowings with similar terms and maturities.

Cash paid for interest for the Company's borrowings and deposits approximated interest expense in fiscal 1998, 1997 and 1996.

7 COMMITMENTS AND CONTINGENCIES

The Company has non-cancelable operating leases covering office space and equipment. At November 30, 1998, future minimum rental commitments under such leases (net of subleases, principally on office rentals) were as follows:

<i>(dollars in millions)</i>	
1999	\$363
2000	324
2001	286
2002	238
2003	193
Thereafter	959

Occupancy lease agreements, in addition to base rentals, generally provide for rent and operating expense escalations resulting from increased assessments for real estate taxes and other charges. Total rent expense, net of sublease rental income, was \$274 million, \$262 million and \$264 million in fiscal 1998, 1997 and 1996, respectively.

The Company has an agreement with IBM, under which the Company receives information processing, data networking and related services. Under the terms of the agreement, the Company has an aggregate minimum annual commitment of \$166 million subject to annual cost-of-living adjustments.

In November 1998, the Company announced that it had entered into an agreement that will result in the development of an office tower in New York City. Pursuant to this agreement, the Company has entered into a 99-year lease for the land at the proposed development site.

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 income for such period.

The Company had approximately \$5.7 billion of letters of credit outstanding at November 30, 1998 to satisfy various collateral requirements.

Financial instruments sold, not yet purchased represent obligations of the Company to deliver specified financial instruments at contracted prices, thereby creating commitments to purchase the financial instruments in the market at prevailing prices. Consequently, the Company's ultimate obligation to satisfy the sale of financial instruments sold, not yet purchased may exceed the amounts recognized in the consolidated statements of financial condition.

The Company also has commitments to fund certain fixed assets and other less liquid investments, including at November 30, 1998 approximately \$181 million in connection with its private equity and other principal investment activities. Additionally, the Company has provided and will continue to provide financing, including margin lending and other extensions of credit to clients (including subordinated loans on an interim basis to leveraged companies associated with its investment banking and its private equity and other principal investment activities), that may subject the Company to increased credit and liquidity risks.

8 EARNINGS PER SHARE

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

BASIC EPS:	FISCAL 1998	fiscal 1997	fiscal 1996
Income before cumulative effect of accounting change	\$3,393	\$2,586	\$1,980
Cumulative effect of accounting change	(117)	—	—
Preferred stock dividend requirements	(55)	(66)	(66)
Net income available to common shareholders	\$3,221	\$2,520	\$1,914
Weighted average common shares outstanding	576	575	573
Basic EPS before cumulative effect of accounting change	\$ 5.80	\$ 4.38	\$ 3.34
Cumulative effect of accounting change	\$ (0.20)	—	—
Basic EPS	\$ 5.60	\$ 4.38	\$ 3.34
DILUTED EPS:	FISCAL 1998	fiscal 1997	fiscal 1996
Income before cumulative effect of accounting change	\$3,393	\$2,586	\$1,980
Cumulative effect of accounting change	(117)	—	—
Preferred stock dividend requirements	(47)	(61)	(62)
Net income available to common shareholders	\$3,229	\$2,525	\$1,918
Weighted average common shares outstanding	576	575	573
Effect of dilutive securities:			
Stock options	18	19	21
ESOP convertible preferred stock	12	12	13
Weighted average common shares outstanding and common stock equivalents	606	606	607
Diluted EPS before cumulative effect of accounting change	\$ 5.52	\$ 4.16	\$ 3.16
Cumulative effect of accounting change	\$ (0.19)	—	—
Diluted EPS	\$ 5.33	\$ 4.16	\$ 3.16

9 TRADING ACTIVITIES**TRADING REVENUES**

The Company's trading activities include providing securities brokerage, derivatives dealing and underwriting services to clients. While trading activities are generated by client order flow, the Company also takes proprietary positions based on expectations of future market movements and conditions. The Company's trading strategies rely on the integrated management of its client-driven and proprietary transactions, along with the hedging and financing of these positions.

The Company manages its trading businesses by product groupings and therefore has established distinct, worldwide trading divisions having responsibility for equity, fixed income, foreign exchange and commodities products. Because of the integrated nature of the markets for such products, each product area trades cash instruments as well as related derivative products (i.e., options, swaps, futures, forwards and other contracts with respect to such underlying instruments or commodities). Revenues related to principal trading are summarized below by trading division:

(dollars in millions)	FISCAL 1998	fiscal 1997	fiscal 1996
Equities	\$2,056	\$1,310	\$1,181
Fixed Income	455	1,187	1,172
Foreign Exchange	587	500	169
Commodities	193	194	137
Total principal trading revenues	\$3,291	\$3,191	\$2,659

Interest revenue and expense are integral components of trading activities. In assessing the profitability of trading activities, the Company views net interest and principal trading revenues in the aggregate.

The Company's trading portfolios are managed with a view toward the risk and profitability of the portfolios to the Company. The nature of the equities, fixed income, foreign exchange and commodities activities conducted by the Company, including the use of derivative products in these businesses, and the market, credit and concentration risk management policies and procedures covering these activities are discussed below.

EQUITIES

The Company makes markets and trades in the global secondary markets for equities and convertible debt and is a dealer in equity warrants, exchange traded and OTC equity options, index futures, equity swaps and other sophisticated equity derivatives. The Company's activities as a dealer primarily are client-driven, with the objective of meeting clients' needs while earning a spread between the premiums paid or received on its contracts with clients and the cost of hedging such transactions in the cash or forward market or with other derivative transactions. The Company limits its market risk related to these contracts, which stems primarily from underlying equity/index price and volatility movements, by employing a variety of hedging strategies, such as delta hedging (delta is a measure of a derivative contract's price movement based on the movement of the price of the security or index underlying the contract). The Company also takes proprietary positions in the global equity markets by using derivatives, most commonly futures and options, in addition to cash positions, intending to profit from market price and volatility movements in the underlying equities or indices positioned.

Equity option contracts give the purchaser of the contract the right to buy (call) or sell (put) the equity security or index underlying the contract at an agreed-upon price (strike price) during or at the conclusion of a specified period of time. The seller (writer) of the contract is subject to market risk, and the purchaser is subject to market risk (to the extent of the premium paid) and credit risk. Equity swap contracts are contractual agreements whereby one counterparty receives the appreciation (or pays the depreciation) on an equity investment in return for paying another rate, often based upon equity index movements or interest rates. The counterparties to the Company's equity transactions include commercial banks, investment banks, broker-dealers, investment funds and industrial companies.

FIXED INCOME

The Company is a market-maker for U.S. and non-U.S. government securities, corporate bonds, money market instruments, medium-term notes and Eurobonds, high-yield securities, emerging market secu-

rities, mortgage and other asset-backed securities, preferred stock and tax-exempt securities. In addition, the Company is a dealer in interest rate and currency swaps and other related derivative products, OTC options on U.S. and non-U.S. government bonds and mortgage-backed forward agreements ("TBA"), options and swaps. In this capacity, the Company facilitates asset and liability management for its customers in interest rate and currency swaps and related products and OTC government bond options.

Swaps used in fixed income trading are, for the most part, contractual agreements to exchange interest payment streams (i.e., an interest rate swap may involve exchanging fixed for floating interest payments) or currencies (i.e., a currency swap may involve exchanging yen for U.S. dollars in one year at an agreed-upon exchange rate). The Company profits by earning a spread between the premium paid or received for these contracts and the cost of hedging such contracts. The Company seeks to manage the market risk of its swap portfolio, which stems from interest rate and currency movements and volatility, by using modeling that quantifies the sensitivity of its portfolio to movements in interest rates and currencies and by adding positions to or selling positions from its portfolio as needed to minimize such sensitivity. Typically, the Company adjusts its positions by entering into additional swaps or interest rate and foreign currency futures or foreign currency forwards and by purchasing or selling additional underlying government bonds. The Company manages the risk related to its option portfolio by using a variety of hedging strategies such as delta hedging, which includes the use of futures and forward contracts to hedge market risk. The Company also is involved in using debt securities to structure products with multiple risk/return factors designed to suit investor objectives.

The Company is an underwriter of and a market-maker in mortgage-backed securities and collateralized mortgage obligations ("CMO") as well as commercial, residential and real estate loan products. The Company also structures mortgage-backed swaps for its clients, enabling them to derive the cash flows from an underlying mortgage-backed security without purchasing the cash position. The Company earns the spread between the premium inherent in the swap and the cost of hedging the swap contract through the use of cash positions or TBA contracts. The Company also uses TBAs in its

role as a dealer in mortgage-backed securities and facilitates customer trades by taking positions in the TBA market. Typically, these positions are hedged by offsetting TBA contracts or underlying cash positions. The Company profits by earning the bid-offer spread on such transactions. Further, the Company uses TBAs to ensure delivery of underlying mortgage-backed securities in its CMO issuance business. As is the case with all mortgage-backed products, market risk associated with these instruments results from interest rate fluctuations and changes in mortgage prepayment speeds. The counterparties to the Company's fixed income transactions include investment advisors, commercial banks, insurance companies, investment funds and industrial companies.

FOREIGN EXCHANGE

The Company is a market-maker in a number of foreign currencies. In this business, it actively trades currencies in the spot and forward markets earning a dealer spread. The Company seeks to manage its market risk by entering into offsetting positions. The Company conducts an arbitrage business in which it seeks to profit from inefficiencies between the futures, spot and forward markets. The Company also makes a market in foreign currency options. This business largely is client-driven and involves the purchasing and writing of European and American style options and certain sophisticated products to meet specific client needs. The Company profits in this business by earning spreads between the options' premiums and the cost of the hedging of such positions. The Company limits its market risk by using a variety of hedging strategies, including the buying and selling of the currencies underlying the options based upon the options' delta equivalent. Foreign exchange option contracts give the purchaser of the contract the right to buy (call) or sell (put) the currency underlying the contract at an agreed-upon strike price at or over a specified period of time. Forward contracts and futures represent commitments to purchase or sell the underlying currencies at a specified future date at a specified price. The Company also takes proprietary positions in currencies to profit from market price and volatility movements in the currencies positioned.

The majority of the Company's foreign exchange business relates to major foreign currencies such as deutsche marks, yen, pound sterling, French francs, Swiss francs, Italian lire, Canadian dollars and, effective January 1, 1999, the euro. The balance of the business covers a broad range of other currencies. The counterparties to the Company's foreign exchange transactions include commercial banks, investment banks, broker-dealers, investment funds and industrial companies.

COMMODITIES

The Company, as a major participant in the world commodities markets, trades in physical precious, base and platinum group metals, electricity, energy products (principally oil, refined oil products and natural gas) as well as a variety of derivatives related to these commodities such as futures, forwards and exchange traded and OTC options and swaps. Through these activities, the Company provides clients with a ready market to satisfy end users' current raw material needs and facilitates their ability to hedge price fluctuations related to future inventory needs. The former activity at times requires the positioning of physical commodities. Derivatives on those commodities, such as futures, forwards and options, often are used to hedge price movements in the underlying physical inventory. The Company profits as a market-maker in physical commodities by capturing the bid-offer spread inherent in the physical markets.

To facilitate hedging for its clients, the Company often is required to take positions in the commodity markets in the form of forward, option and swap contracts involving oil, natural gas, precious and base metals, and electricity. The Company generally hedges these positions by using a variety of hedging techniques such as delta hedging, whereby the Company takes positions in the physical markets and/or positions in other commodity derivatives such as futures and forwards to offset the market risk in the underlying derivative. The Company profits from this business by earning a spread between the premiums paid or received for these derivatives and the cost of hedging such derivatives.

The Company also maintains proprietary trading positions in commodity derivatives, including futures, forwards and options in addition to physical commodities, to profit from price and volatility movements in the underlying commodities markets.

Forward, option and swap contracts on commodities are structured similarly to like-kind derivative contracts for cash financial instruments. The counterparties to OTC commodity contracts include precious metals producers, refiners and consumers as well as shippers, central banks, and oil, gas and electricity producers.

The following discussions of risk management, market risk, credit risk, concentration risk and customer activities relate to the Company's trading activities.

RISK MANAGEMENT

Risk management at the Company is a multi-faceted process with independent oversight which requires constant communication, judgment and knowledge of specialized products and markets. The Company's senior management takes an active role in the risk management process and has developed policies and procedures that require specific administrative and business functions to assist in the identification, assessment and control of various risks. In recognition of the increasingly varied and complex nature of the global financial services business, the Company's risk management policies and procedures are evolutionary in nature and are subject to ongoing review and modification. Many of the Company's risk management and control practices are subject to periodic review by the Company's internal auditors as well as to interactions with various regulatory authorities.

The Management Committee, composed of the Company's most senior officers, establishes the overall risk management policies for the Company and reviews the Company's performance relative to these policies. The Management Committee has created several Risk Committees to assist it in monitoring and reviewing the Company's risk management practices. These Risk Committees, among other matters, review the general framework, levels and monitoring procedures relating to the Company's market and credit risk profile, sales practices, legal enforceability and operational

and systems risks. The Controllers, Treasury, Law, Compliance and Governmental Affairs and Firm Risk Management Departments, which are all independent of the Company's business units, assist senior management and the Risk Committees in monitoring and controlling the Company's risk profile. In addition, the Internal Audit Department, which also reports to senior management, periodically examines and evaluates the Company's operations and control environment. The Company continues to be committed to employing qualified personnel with appropriate expertise in each of its various administrative and business areas to implement effectively the Company's risk management and monitoring systems and processes.

MARKET RISK

Market risk refers to the risk that a change in the level of one or more market prices, rates, indices, volatilities, correlations or other market factors, such as liquidity, will result in losses for a specified position or portfolio.

The Company manages the market risk associated with its trading activities on a Company-wide basis, on a trading division level worldwide and on an individual product basis. Market risk limits have been approved for the Company and each trading division of the Company worldwide. Discrete market risk limits are assigned to trading divisions and trading desks and, as appropriate, products and regions, that are compatible with the trading division limits. Trading division risk managers, desk risk managers and the Firm Risk Management Department all monitor market risk measures against limits and report major market and position events to senior management.

The Firm Risk Management Department independently reviews the Company's trading portfolios on a regular basis from a market risk perspective utilizing Value-at-Risk and other quantitative and qualitative risk measurements and analyses. The Company may use measures, such as rate sensitivity, convexity, volatility and time decay measurements, to estimate market risk and to assess the sensitivity of positions to changes in market conditions. Stress testing, which measures the impact on the value of existing portfolios

of specified changes in market factors, for certain products is performed periodically and is reviewed by trading division risk managers, desk risk managers and the Firm Risk Management Department.

CREDIT RISK

The Company's exposure to credit risk arises from the possibility that a counterparty to a transaction might fail to perform under its contractual commitment, which could result in the Company incurring losses. The Company has credit guidelines which limit the Company's credit exposure to any one counterparty. Specific credit risk limits based on the credit guidelines also are in place for each type of counterparty (by rating category) as well as for secondary positions of high-yield and emerging market debt.

The Credit Department administers and monitors the credit limits among trading divisions on a worldwide basis. In addition to monitoring credit limits, the Company manages the credit exposure relating to the Company's trading activities by reviewing counterparty financial soundness periodically, by entering into master netting agreements and collateral arrangements with counterparties in appropriate circumstances and by limiting the duration of exposure. In certain cases, the Company also may close out transactions or assign them to other counterparties to mitigate credit risk.

CONCENTRATION RISK

The Company is subject to concentration risk by holding large positions in certain types of securities or commitments to purchase securities of a single issuer, including sovereign governments and other entities, issuers located in a particular country or geographic area, public and private issuers involving developing countries or issuers engaged in a particular industry. Financial instruments owned by the Company include U.S. government and agency securities and securities issued by other sovereign governments (principally Japan, Germany and Italy), which, in the aggregate, represented approximately 9% of the Company's total assets at November 30, 1998. In addition, substantially all of the collateral held by the Company for resale agreements or bonds borrowed, which together represented approximately 33% of the Company's total assets at November

30, 1998, consists of securities issued by the U.S. government, federal agencies or other sovereign government obligations. Positions taken and commitments made by the Company, including positions taken and underwriting and financing commitments made in connection with its private equity and 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 through the use of the systems and procedures described in the preceding discussions of market and credit risk.

CUSTOMER ACTIVITIES

The Company's customer activities involve the execution, settlement and financing of various securities and commodities transactions on behalf of customers. Customer securities activities are transacted on either a cash or margin basis. Customer commodities activities, which include the execution of customer transactions in commodity futures transactions (including options on futures), are transacted on a margin basis.

The Company's customer activities may expose it to off-balance sheet credit risk. The Company may have to purchase or sell financial instruments at prevailing market prices in the event of the failure of a customer to settle a trade on its original terms or in the event cash and securities in customer margin accounts are not sufficient to fully cover customer losses. The Company seeks to control the risks associated with customer activities by requiring customers to maintain margin collateral in compliance with various regulations and Company policies.

NOTIONAL/CONTRACT AMOUNTS AND FAIR VALUES OF DERIVATIVES

The gross notional or contract amounts of derivative instruments and fair value (carrying amount) of the related assets and liabilities at November 30, 1998 and 1997, as well as the average fair value of those assets and liabilities for fiscal 1998 and 1997, are presented in the table which follows. Fair value represents the cost of replacing these instruments and is further described in Note 2. Future

changes in interest rates, foreign currency exchange rates or the fair values of the financial instruments, commodities or indices underlying these contracts may ultimately result in cash settlements exceeding fair value amounts recognized in the consolidated statements of financial condition. Assets represent unrealized gains on purchased exchange traded and OTC options and other contracts (including interest rate, foreign exchange and other forward contracts

and swaps) net of any unrealized losses owed to the counterparties on offsetting positions in situations where netting is appropriate. Similarly, liabilities represent net amounts owed to counterparties. These amounts will vary based on changes in the fair values of underlying financial instruments and/or the volatility of such underlying instruments:

FISCAL YEAR-END GROSS NOTIONAL/CONTRACT AMOUNT ⁽¹⁾⁽²⁾ (dollars in billions at fiscal year-end)		FISCAL YEAR-END FAIR VALUES ⁽³⁾				AVERAGE FAIR VALUES ⁽³⁾⁽⁴⁾				
1998	1997	Assets		Liabilities		Assets		Liabilities		
		1998	1997	1998	1997	1998	1997	1998	1997	
\$1,719	\$1,262	Interest rate and currency swaps and options (including caps, floors and swap options) and other fixed income securities contracts	\$10.1	\$ 7.1	\$10.4	\$ 6.4	\$ 9.5	\$ 4.8	\$ 8.6	\$ 5.9
903	1,035	Foreign exchange forward and futures contracts and options	3.7	4.6	4.1	4.2	4.6	3.4	4.4	3.2
107	112	Equity securities contracts (including equity swaps, futures contracts, and warrants and options)	5.2	3.8	4.8	3.8	4.8	2.6	4.6	2.6
91	78	Commodity forwards, futures, options and swaps	2.2	1.3	1.9	1.2	2.0	1.1	1.7	0.9
40	42	Mortgage-backed securities forward contracts, swaps and options	0.2	0.3	—	—	0.2	0.3	—	—
\$2,860	\$2,529	Total	\$21.4	\$17.1	\$21.2	\$15.6	\$21.1	\$12.2	\$19.3	\$12.6

(1) The notional amounts of derivatives have been adjusted to reflect the effects of leverage, where applicable.

(2) Notional amounts include purchased and written options of \$485 billion and \$442 billion, respectively, at November 30, 1998, and \$572 billion and \$549 billion, respectively, at November 30, 1997.

(3) These amounts represent carrying value (exclusive of collateral) at November 30, 1998 and 1997, respectively, and do not include receivables or payables related to exchange traded futures contracts.

(4) Amounts are calculated using a monthly average.

The gross notional or contract amounts of these instruments are indicative of the Company's degree of use of derivatives for trading purposes but do not represent the Company's exposure to market or credit risk. Credit risk arises from the failure of a counterparty to perform according to the terms of the contract. The Company's exposure to credit risk at any point in time is represented by the fair value of the contracts reported as assets. 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 Company monitors the creditworthiness of counterparties to these transactions on an ongoing basis and requests additional collateral when deemed necessary. The Company believes the ultimate settlement of the transactions outstanding at November 30, 1998 will not have a material effect on the Company's financial condition.

The remaining maturities of the Company's swaps and other derivative products at November 30, 1998 and 1997 are sum-

marized in the following table, showing notional values by year of expected maturity:

(dollars in billions)	<i>Less than 1 Year</i>	<i>1 to 3 Years</i>	<i>3 to 5 Years</i>	<i>More than 5 Years</i>	TOTAL
AT NOVEMBER 30, 1998					
Interest rate and currency swaps and options (including caps, floors and swap options)					
and other fixed income securities contracts	\$ 457	\$479	\$371	\$412	\$1,719
Foreign exchange forward and futures contracts and options	892	11	—	—	903
Equity securities contracts (including equity swaps, futures contracts, and warrants and options)	82	17	7	1	107
Commodity forwards, futures, options and swaps	53	22	8	8	91
Mortgage-backed securities forward contracts, swaps and options	25	1	2	12	40
Total	\$1,509	\$530	\$388	\$433	\$2,860
Percent of total	53%	19%	13%	15%	100%
AT NOVEMBER 30, 1997					
Interest rate and currency swaps and options (including caps, floors and swap options)					
and other fixed income securities contracts	\$ 319	\$398	\$235	\$310	\$1,262
Foreign exchange forward and futures contracts and options	1,026	7	2	—	1,035
Equity securities contracts (including equity swaps, futures contracts, and warrants and options)	87	17	7	1	112
Commodity forwards, futures, options and swaps	58	14	4	2	78
Mortgage-backed securities forward contracts, swaps and options	20	1	4	17	42
Total	\$1,510	\$437	\$252	\$330	\$2,529
Percent of total	60%	17%	10%	13%	100%

The credit quality of the Company's trading-related derivatives at November 30, 1998 and 1997 is summarized in the table below, showing the fair value of the related assets by counterparty credit

rating. The actual credit ratings are determined by external rating agencies or by equivalent ratings used by the Company's Credit Department:

(dollars in millions)	AAA	AA	A	BBB	Collateralized Non- Investment Grade	Other Non- Investment Grade	TOTAL
AT NOVEMBER 30, 1998							
Interest rate and currency swaps and options (including caps, floors and swap options) and other fixed income securities contracts							
\$ 894	\$ 3,727	\$ 3,694	\$ 1,181	\$ 98	\$ 510	\$ 10,104	
306	1,413	1,435	337	—	263	3,754	
Equity securities contracts (including equity swaps, warrants and options)	1,995	1,105	478	61	1,364	165	5,168
Commodity forwards, options and swaps	71	448	401	708	46	534	2,208
Mortgage-backed securities forward contracts, swaps and options	130	51	21	3	—	3	208
Total	\$3,396	\$6,744	\$6,029	\$2,290	\$1,508	\$1,475	\$21,442
Percent of total	16%	31%	28%	11%	7%	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	
788	2,504	1,068	72	—	176	4,608	
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
Mortgage-backed securities forward contracts, swaps and options	156	90	50	2	—	10	308
Total	\$2,909	\$6,697	\$4,609	\$1,055	\$825	\$1,051	\$17,146
Percent of total	17%	39%	27%	6%	5%	6%	100%

The Company also has obtained assets posted as collateral by investment grade counterparties amounting to \$2.5 billion and \$1.2 billion at November 30, 1998 and November 30, 1997, respectively.

10 PREFERRED STOCK, CAPITAL UNITS AND PREFERRED SECURITIES ISSUED BY SUBSIDIARIES

Preferred stock of the Company is composed of the following issues:

(dollars in millions)	Shares Outstanding at November 30	Balance at November 30
	1998	1997
ESOP Convertible Preferred Stock, liquidation preference \$35.88	3,581,964	\$129
Series A Fixed/Adjustable Rate Cumulative Preferred Stock, stated value \$200	1,725,000	345
7-3/4% Cumulative Preferred Stock, stated value \$200	1,000,000	200
7-3/8% Cumulative Preferred Stock, stated value \$200	—	200
Total	1,000,000	—
	\$674	\$876

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

During fiscal 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.

During fiscal 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 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 November 30, 1998 and 1997.

In January 1999, the Company and MS plc called for redemption all of the outstanding 7.82% Capital Units and 7.80% Capital Units on February 28, 1999. The aggregate principal amount of the Capital Units to be redeemed is \$352 million.

The estimated fair value of the Capital Units approximated carrying value at November 30, 1998 and November 30, 1997.

11 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 requirements. MS&Co.'s net capital totaled \$3,205 million at November 30, 1998, which exceeded the amount required by \$2,699 million. DWR's net capital totaled \$752 million at November 30, 1998, which exceeded the amount required by \$668 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 November 30, 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. Morgan Stanley Derivative Products Inc., the Company's triple-A rated derivative products subsidiary, also has established certain operating restrictions which have been reviewed by various rating agencies.

The regulatory capital requirements referred to above, and certain covenants contained in various agreements governing indebtedness of the Company, may restrict the Company's ability to withdraw capital from its subsidiaries. At November 30, 1998, approximately \$4.9 billion of net assets of consolidated subsidiaries may be restricted as to the payment of cash dividends and advances to the Company.

Cumulative translation adjustments include gains or losses resulting from translating foreign currency financial statements from their respective functional currencies to U.S. dollars, net of hedge gains or losses and related tax effects. The Company uses foreign currency contracts and designates certain non-U.S. dollar currency debt as hedges to manage the currency exposure relating to its net monetary investments in non-U.S. dollar functional currency subsidiaries. Increases or decreases in the value of the Company's net foreign investments generally are tax-deferred for U.S. purposes, but the related hedge gains and losses are taxable currently. Therefore, the gross notional amounts of the contracts and debt designated as hedges exceed the Company's net foreign investments to result in effective hedging on an after-tax basis. The Company attempts to protect its net book value from the effects of fluctuations in currency exchange rates on its net monetary investments in non-U.S. dollar subsidiaries by selling the appropriate non-U.S.

dollar currency in the forward market. However, under some circumstances, the Company may elect not to hedge its net monetary investments in certain foreign operations due to market conditions, including the availability of various currency contracts at acceptable costs. Information relating to the hedging of the Company's net monetary investments in non-U.S. dollar functional currency subsidiaries and their effects on cumulative translation adjustments is summarized below:

	<i>At November 30</i>	
	<i>1998</i>	<i>1997</i>
Net monetary investments in non-U.S. dollar functional currency subsidiaries	\$1,364	\$1,128
Gross notional amounts of foreign exchange contracts and non-U.S. dollar debt designated as hedges⁽¹⁾	\$2,239	\$1,881
Cumulative translation adjustments resulting from net investments in subsidiaries with a non-U.S. dollar functional currency	\$ 29	\$ 6
Cumulative translation adjustments resulting from realized or unrealized gains or losses on hedges, net of tax	\$ (41)	\$ (15)
Total cumulative translation adjustments	\$ (12)	\$ (9)

(1) Notional amounts represent the contractual currency amount translated at respective fiscal year-end spot rates.

12 EMPLOYEE COMPENSATION PLANS

The Company has adopted a variety of compensation plans for certain of its employees as well as the Company's non-employee directors. These plans are designed to facilitate a pay-for-performance policy, provide compensation commensurate with other leading financial services companies and provide for internal ownership in order to align the interests of employees with the long-term interests of the Company's shareholders. These plans are summarized below.

EQUITY-BASED COMPENSATION PLANS

The Company is authorized to issue up to approximately 270 million shares of its common stock in connection with awards under its equity-

based compensation plans. At November 30, 1998, approximately 150 million shares were available for future grant under these plans.

Stock Option Awards

Stock option awards have been granted pursuant to several equity-based compensation plans. Historically, these plans have generally

provided for the granting of stock options having an exercise price not less than the fair value of the Company's common stock (as defined in the plan) on the date of grant. Such options generally become exercisable over a one-to-five year period and expire seven to 10 years from the date of grant.

The following table sets forth activity relating to the Company's stock option awards (share data in millions):

	FISCAL 1998	FISCAL 1997	FISCAL 1996			
	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding at beginning of period	64.1	\$27.85	60.3	\$17.04	63.1	\$14.46
Granted	15.6	68.77	20.2	48.16	7.5	30.15
Exercised	(15.3)	18.23	(14.9)	11.68	(9.0)	9.45
Forfeited	(1.1)	39.40	(1.5)	26.66	(1.3)	21.14
Options outstanding at end of period	63.3	\$40.08	64.1	\$27.85	60.3	\$17.04
Options exercisable at end of period	40.6	\$39.37	44.3	\$26.67	36.4	\$13.82

The following table presents information relating to the Company's stock options outstanding at November 30, 1998 (share data in millions):

Range of Exercise Prices	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE		
	Number Outstanding	Weighted Average Exercise Price	Average Remaining Life (Years)	Number Exercisable	Weighted Average Exercise Price	
\$ 8.00 – \$19.99	22.7	\$17.29	5.9	17.9	\$17.09	
\$20.00 – \$29.99	2.0	24.02	3.3	1.0	23.35	
\$30.00 – \$39.99	7.9	32.13	5.5	1.3	32.42	
\$40.00 – \$49.99	4.4	43.47	8.6	3.8	43.47	
\$50.00 – \$59.99	15.0	54.90	8.1	9.2	55.64	
\$60.00 – \$69.99	0.5	63.08	7.1	0.5	62.88	
\$70.00 – \$79.99	9.5	71.56	9.8	5.7	71.73	
\$80.00 – \$96.00	1.3	89.90	7.1	1.2	90.00	
Total	63.3		7.1	40.6		

Deferred Compensation Awards

The Company has made deferred compensation awards pursuant to several equity-based compensation plans. These plans provide for the deferral of a portion of certain key employees' compensation with payments made in the form of the Company's common stock or in the right to receive unrestricted shares (collectively, "Restricted

Stock"). Compensation expense for all such awards (including those subject to forfeiture) amounted to \$415 million, \$347 million and \$534 million in fiscal 1998, fiscal 1997 and fiscal 1996, respectively. Compensation expense for Restricted Stock awards was determined based on the fair value of the Company's common stock (as defined in the plans). The number of Restricted Stock shares outstanding were 59 million at fiscal year-end 1998, 62 million at fiscal year-end 1997, and 65 million at fiscal year-end 1996.

Restricted Stock awarded under these plans are subject to restrictions on sale, transfer or assignment until the end of a specified restriction period, generally 5 to 10 years from the date of grant. Holders of Restricted Stock generally may forfeit ownership of a portion of their award if employment is terminated before the end of the relevant restriction period. Holders of vested Restricted Stock generally will forfeit ownership only in certain limited situations, including termination for cause during the restriction period.

Employee Stock Purchase Plan

Under the Employee Stock Purchase Plan, eligible employees may purchase shares of the Company's common stock at not less than

85% of the fair value on the date of purchase. Employees of the Company purchased 0.6 million shares of common stock in fiscal 1998, 0.5 million shares in fiscal 1997 and 0.7 million shares in fiscal 1996.

The discount to fair value was \$6 million for fiscal 1998 and \$3 million for both fiscal 1997 and fiscal 1996. The plan is "non-compensatory" under APB No. 25, and, accordingly, no charge to earnings has been recorded for the amount of the discount to fair value.

Non-Employee Director Awards

The Company sponsors an equity-based plan for non-employee directors under which shares of the Company's common stock have been authorized for issuance in the form of option grants, stock awards or deferred compensation. The effect of these grants on results of operations was not material.

OTHER COMPENSATION PLANS

Capital Accumulation Plan

Under the Capital Accumulation Plan ("CAP"), vested units consisting of unsecured rights to receive payments based on notional interests in existing and future risk-capital investments made directly or indirectly by the Company ("CAP Units") are granted to key employees. The value of the CAP Units awarded for services rendered in fiscal 1998, 1997 and 1996 was approximately \$15 million, \$14 million and \$7 million, respectively, all of which relate to vested units.

Carried Interest Plans

Under various Carried Interest Plans, certain key employees effectively participate in a portion of the Company's realized gains from certain of its equity investments in private equity transactions. Compensation expense for fiscal 1998, 1997 and 1996 related to these plans aggregated \$33 million, \$38 million and \$0.2 million, respectively.

Real Estate Fund Plans

Under various plans, select employees and consultants to certain partnerships may participate in certain gains realized by the Company's real estate funds. Compensation expense relating to these plans aggregated \$3 million, \$8 million and \$13 million for fiscal 1998, fiscal 1997 and fiscal 1996, respectively.

Profit Sharing Plans

The Company sponsors qualified profit sharing plans covering substantially all U.S. employees and also provides cash payment of profit sharing to employees of its international subsidiaries. Contributions are made to eligible employees at the discretion of management based upon the financial performance of the Company. Total profit sharing expense for fiscal 1998, fiscal 1997 and fiscal 1996 was \$115 million, \$113 million and \$72 million, respectively.

Employee Stock Ownership Plan

The Company has a \$140 million leveraged employee stock ownership plan, funded through an independently managed trust. The Employee Stock Ownership Plan ("ESOP") was established to broaden internal ownership of the Company and to provide benefits to its employees in a cost-effective manner. Each of the 3,581,964 preferred shares outstanding at November 30, 1998 is held by the ESOP trust, is convertible into 3.3 shares of the Company's common stock and is entitled to annual dividends of \$2.78 per preferred share. The ESOP trust funded its stock purchase through a loan of \$140 million from the Company. The ESOP trust note, due September 19, 2005 (extendible at the option of the ESOP trust to September 19, 2010), bears a 10-3/8% interest rate per annum with principal payable without penalty on or before the due date. The ESOP trust expects to make principal and interest payments on the note from funds provided by dividends on the shares of convertible preferred stock and contributions from the Company. The note receivable

from the ESOP trust is reflected as a reduction in the Company's shareholders' equity. Shares allocated to employees generally may not be withdrawn until the employee's death, disability, retirement or termination. Upon withdrawal, each share of ESOP preferred stock generally will be converted into 3.3 shares of the Company's common stock. If the fair value of such 3.3 common shares at conversion is less than the \$35.88 liquidation value of an ESOP preferred share, the Company will pay the withdrawing employee the difference in additional common shares or cash.

Contributions to the ESOP by the Company and allocation of ESOP shares to employees are made annually at the discretion of the Board of Directors. The cost of shares allocated to participants' accounts amounted to \$8 million in both fiscal 1998 and fiscal 1997, and \$9 million in fiscal 1996. The ESOP debt service costs for fiscal 1998, fiscal 1997 and fiscal 1996 were paid from dividends received on preferred stock held by the plan and from Company contributions.

PRO FORMA EFFECT OF SFAS NO. 123

Had the Company elected to recognize compensation cost pursuant to SFAS No. 123 for its stock option plans and the Employee Stock Purchase Plan, net income would have been reduced by \$214 million, \$196 million and \$41 million for fiscal 1998, 1997 and 1996, respectively. Basic and diluted earnings per common share would have been reduced by \$0.38, \$0.34 and \$0.07 for fiscal 1998, 1997 and 1996, respectively.

The weighted average fair value at date of grant for stock options granted during fiscal 1998, 1997 and 1996 was \$22.37, \$16.76 and \$9.08 per option, respectively. The fair value of stock options at date of grant was estimated using the Black-Scholes option pricing model utilizing the following weighted average assumptions:

	FISCAL 1998	<i>fiscal</i> 1997	<i>fiscal</i> 1996
Risk-free interest rate	4.9%	6.0%	5.5%
Expected option life in years	4.8	6.0	5.3
Expected stock price volatility	33.2%	28.0%	27.5%
Expected dividend yield	1.3%	1.3%	1.6%

13 EMPLOYEE BENEFIT PLANS

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

PENSION PLANS

Substantially all of the U.S. employees of the Company and its U.S. affiliates are covered by non-contributory pension plans that are qualified under Section 401(a) of the Internal Revenue Code (the "Qualified Plans"). Unfunded supplementary plans (the "Supplemental Plans") cover certain executives. In addition to the Qualified Plans and the Supplemental Plans (collectively, the "U.S. Plans"), nine of the Company's international subsidiaries also have pension plans covering substantially all of their employees. These pension plans generally provide pension benefits that are based on each employee's years of credited service and on compensation levels specified in the plans. For the Qualified Plans and the other international plans, the Company's policy is to fund at least the amounts sufficient to meet minimum funding requirements under applicable employee benefit and tax regulations. Liabilities for benefits payable under the Supplemental Plans are accrued by the Company and are funded when paid to the beneficiaries.

Company's pension plan assets are not included in the statement of financial position because the Company's pension plan assets are not available to meet the obligations of the plan on a current basis.

Pension expense is comprised of the following components:

	FISCAL 1998
U.S. Plan	
Service cost for employees during the year	72
Interest cost on benefits previously accrued	18
Return on plan assets	(7)
Difference between expected and actual return on plan assets	(10)
Net expense	63
Total	56

(dollars in millions)

POSTRETIREMENT BENEFITS

The Company has unfunded postretirement benefit plans that provide medical and life insurance for eligible retirees, employees and dependents. At November 30, 1998 and 1997, the Company's accrued postretirement benefit costs were \$95 million and \$91 million, respectively.

POSTEMPLOYMENT BENEFITS

Postemployment benefits include, but are not limited to, salary continuation, supplemental unemployment benefits, severance benefits, disability-related benefits, and continuation of health care and life insurance coverage provided to former or inactive employees after employment but before retirement. These benefits were not material to the consolidated financial statements in fiscal 1998, 1997 and 1996.

14. INCOME TAXES

The provision for income taxes consists of:

(dollars in millions)	FISCAL 1998	fiscal 1997	fiscal 1996
Current			
U.S. federal	\$1,199	\$1,079	\$1,096
U.S. state and local	372	348	290
Non-U.S.	476	338	177
	2,047	1,765	1,563
Deferred			
U.S. federal	(26)	(45)	(326)
U.S. state and local	1	(17)	(74)
Non-U.S.	(30)	(15)	(26)
	(55)	(77)	(426)
Provision for income taxes	\$1,992	\$1,688	\$1,137

The following table reconciles the provision to the U.S. federal statutory income tax rate:

	FISCAL 1998	fiscal 1997	fiscal 1996
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
U.S. state and local income taxes, net of U.S. federal income tax benefits	4.6	5.1	4.6
Lower tax rates applicable to non-U.S. earnings	(2.4)	(1.1)	(1.7)
Reduced tax rate applied to dividends	(0.1)	(0.1)	(0.1)
Other	(0.1)	0.6	(1.3)
Effective income tax rate	37.0%	39.5%	36.5%

As of November 30, 1998, the Company had approximately \$2.6 billion of earnings attributable to foreign subsidiaries for which no provisions have been recorded for income tax that could occur upon repatriation. Except to the extent such earnings can be repatriated tax efficiently, they are permanently invested abroad. It is not practicable to determine the amount of income taxes payable in the event all such foreign earnings are repatriated.

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. Significant components of the Company's deferred tax assets and liabilities at November 30, 1998 and 1997 are as follows:

(dollars in millions)	NOV. 30, 1998	NOV. 30, 1997
Deferred tax assets		
Employee compensation and benefit plans	\$1,289	\$1,168
Loan loss allowance	371	459
Other valuation and liability allowances	604	545
Other	167	180
Total deferred tax assets	2,431	2,352
Deferred tax liabilities		
Prepaid commissions	239	233
Valuation of inventory, investments and receivables	127	298
Other	237	265
Total deferred tax liabilities	603	796
Net deferred tax assets	\$1,828	\$1,556

Cash paid for income taxes was \$1,591 million, \$1,251 million and \$1,190 million in fiscal 1998, 1997 and 1996, respectively.

15 GEOGRAPHIC AREA DATA

Total revenues, net revenues, income before taxes and identifiable assets of the Company's operations by geographic area are as follows:

(dollars in millions)	TOTAL REVENUES			NET REVENUES		
	FISCAL 1998	fiscal 1997	fiscal 1996	FISCAL 1998	fiscal 1997	fiscal 1996
International:						
Europe	\$ 7,541	\$ 6,468	\$ 5,616	\$ 2,786	\$ 1,757	\$ 1,429
Asia	1,176	952	768	1,023	866	700
Total	8,717	7,420	6,384	3,809	2,623	2,129
North America	28,001	28,711	24,235	12,933	12,519	10,193
Eliminations	(5,587)	(8,999)	(8,448)	(298)	(309)	(299)
Total	\$31,131	\$27,132	\$22,171	\$ 16,444	\$ 14,833	\$ 12,023
 INCOME BEFORE TAXES						
(dollars in millions)	FISCAL 1998	fiscal 1997	fiscal 1996	FISCAL 1998	fiscal 1997	fiscal 1996
International:						
Europe	\$ 1,088	\$ 399	\$ 328	\$ 139,923	\$ 126,138	\$ 113,734
Asia	287	240	161	25,712	30,656	21,561
Total	1,375	639	489	165,635	156,794	135,295
North America	4,010	3,635	2,628	337,588	307,728	242,510
Eliminations	—	—	—	(185,633)	(162,235)	(138,945)
Total	\$ 5,385	\$ 4,274	\$ 3,117	\$ 317,590	\$ 302,287	\$ 238,860

Because of the international nature of the financial markets and the resulting geographic integration of the Company's business, the Company manages its business with a view to the profitability of the

enterprise as a whole, and, as such, profitability by geographic area is not necessarily meaningful.

16 SEGMENT INFORMATION

The Company is in the business of providing financial services, and operates in two business segments — Securities and Asset Management and Credit and Transaction Services. Securities and Asset Management engages in delivering a broad range of financial products and services, including asset management, to individual and institutional investors. Credit and Transaction Services is engaged in the issuance and servicing of general purpose credit cards, consumer lending and electronic transaction processing services.

The following table presents certain information regarding these business segments:

(dollars in millions)	FISCAL 1998	fiscal 1997	fiscal 1996
Total revenues:			
Securities and Asset Management	\$ 25,763	\$ 21,499	\$ 17,136
Credit and Transaction Services	5,368	5,633	5,035
Income before income taxes⁽¹⁾:			
Securities and Asset Management	4,187	3,597	2,426
Credit and Transaction Services	1,198	751	691
Identifiable assets at end of period⁽²⁾:			
Securities and Asset Management	297,054	277,878	213,967
Credit and Transaction Services	20,536	24,409	24,893

(1) Excludes merger-related expenses of \$74 million in fiscal 1997.

(2) Corporate assets have been fully allocated to the Company's business segments.

17 BUSINESS DISPOSITIONS

In fiscal 1998, the Company entered into several transactions reflecting its strategic decision to focus on growing its core Securities and Asset Management and Credit and Transaction Services businesses.

In the fourth quarter of fiscal 1998, the Company completed the sale of its Global Custody business. The Company also sold its interest in the operations of SPS Transaction Services, Inc., a 73%-owned, publicly held subsidiary of the Company. In addition, the Company sold certain credit card receivables relating to its discontinued BRAVO Card. The Company's aggregate net pre-tax gain resulting from these transactions was \$685 million.

In addition, during fiscal 1998 the Company sold its Prime OptionSM MasterCard[®] portfolio, a business it had operated with NationsBank of Delaware, N.A., and its Correspondent Clearing business. The gains resulting from the sale of these businesses were not material to the Company's results of operations or financial condition.

18 QUARTERLY RESULTS (UNAUDITED)

(dollars in millions, except share and per share data)	FIRST (RESTATED) ⁽¹⁾	1998 FISCAL QUARTER			1997 FISCAL QUARTER			
		SECOND (RESTATED) ⁽¹⁾	THIRD (RESTATED) ⁽¹⁾	FOURTH	First	Second	Third	Fourth
Revenues:								
Investment banking	\$ 800	\$ 988	\$ 819	\$ 733	\$ 522	\$ 581	\$ 818	\$ 773
Principal transactions:								
Trading	903	1,091	499	798	869	722	778	822
Investments	72	101	(174)	90	56	136	206	65
Commissions	547	611	608	587	490	484	559	553
Fees:								
Asset management, distribution and administration	676	741	718	714	587	610	656	652
Merchant and cardmember	428	404	438	377	436	424	433	411
Servicing	171	232	255	270	202	184	196	180
Interest and dividends	3,933	4,213	4,283	4,007	3,369	3,197	3,570	3,447
Other	55	47	52	44	29	38	41	36
Total revenues	7,585	8,428	7,498	7,620	6,560	6,376	7,257	6,939
Interest expense	3,145	3,554	3,377	3,438	2,709	2,478	2,765	2,854
Provision for consumer loan losses	405	275	280	213	379	376	385	353
Net revenues	4,035	4,599	3,841	3,969	3,472	3,522	4,107	3,732
Non-interest expenses:								
Compensation and benefits	1,788	2,017	1,609	1,222	1,490	1,505	1,849	1,175
Occupancy and equipment	140	143	148	152	128	127	134	137
Brokerage, clearing and exchange fees	121	135	160	136	95	113	130	122
Information processing and communications	267	275	291	307	270	267	249	294
Marketing and business development	294	286	354	477	288	274	293	324
Professional services	128	156	176	217	93	99	127	132
Other	165	190	193	197	180	180	219	191
Merger-related expenses						74		
Total non-interest expenses	2,903	3,202	2,931	2,708	2,544	2,639	3,001	2,375
Gain on sale of businesses				685				
Income before income taxes and cumulative effect of accounting change	1,132	1,397	910	1,946	928	883	1,106	1,357
Provision for income taxes	441	545	284	722	357	356	428	547
Income before cumulative effect of accounting change	691	852	626	1,224	571	527	678	810
Cumulative effect of accounting change	(117)	—	—	—	—	—	—	—
Net income	\$ 574	\$ 852	\$ 626	\$ 1,224	\$ 571	\$ 527	\$ 678	\$ 810
Earnings applicable to common shares ⁽²⁾	\$ 559	\$ 838	\$ 612	\$ 1,212	\$ 552	\$ 509	\$ 663	\$ 796
Basic earnings per share⁽³⁾:								
Income before cumulative effect of accounting change	\$ 1.15	\$ 1.44	\$ 1.07	\$ 2.16	\$ 0.96	\$ 0.88	\$ 1.15	\$ 1.37
Cumulative effect of accounting change	(0.20)	—	—	—	—	—	—	—
Net income	\$ 0.95	\$ 1.44	\$ 1.07	\$ 2.16	\$ 0.96	\$ 0.88	\$ 1.15	\$ 1.37
Diluted earnings per share⁽³⁾:								
Income before cumulative effect of accounting change	\$ 1.10	\$ 1.37	\$ 1.01	\$ 2.07	\$ 0.91	\$ 0.84	\$ 1.09	\$ 1.30
Cumulative effect of accounting change	(0.19)	—	—	—	—	—	—	—
Net income	\$ 0.91	\$ 1.37	\$ 1.01	\$ 2.07	\$ 0.91	\$ 0.84	\$ 1.09	\$ 1.30
Dividends to common shareholders	\$ 0.20	\$ 0.20	\$ 0.20	\$ 0.20	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.14
Book value	\$ 22.48	\$ 21.95	\$ 22.13	\$ 23.88	\$ 18.70	\$ 19.37	\$ 20.25	\$ 22.11
Average common and equivalent shares:								
Basic	586,751,340	581,326,618	573,170,507	560,108,890	573,410,658	577,985,371	578,082,806	580,985,871
Diluted	616,377,562	612,625,354	604,779,594	585,533,337	605,691,066	610,430,898	610,019,122	612,092,405
Stock price range ⁽⁴⁾	\$52.25-70.50	\$69.75-84.44	\$58.06-96.88	\$38.44-74.75	\$32.19-43.75	\$34.50-41.50	\$41.00-53.88	\$47.31-58.75

(1) The quarterly results for the first, second and third quarters of fiscal 1998 have been restated to reflect the effects of the accounting change adopted in the fourth quarter, effective December 1, 1997. As a result of this restatement, net income has been decreased by \$117 million, \$2 million and \$21 million for the first, second and third quarters of fiscal 1998, respectively. For further information regarding the change in accounting, see Note 2.

(2) Amounts shown are used to calculate basic earnings per share.

(3) Summation of the quarters' earnings per common share may not equal the annual amounts due to the averaging effect of the number of shares and share equivalents throughout the year.

(4) Prices represent the range of sales per share on the New York Stock Exchange for the periods indicated. The number of stockholders of record at November 30, 1998 approximated 186,000. The number of beneficial owners of common stock is believed to exceed this number.