

STATE OF ALABAMA
ALABAMA SECURITIES COMMISSION

In the matter of

MORGAN STANLEY & CO.
INCORPORATED (CRD #8209)

Respondent.

ADMINISTRATIVE CONSENT ORDER
NO. CO-2010 -0007

WHEREAS, Morgan Stanley & Co. Incorporated ("Morgan Stanley") is a broker-dealer registered in the state of Alabama; and

WHEREAS, coordinated investigations of the activities of Morgan Stanley in connection with the marketing and sale of auction rate securities ("ARS") have been conducted by a multistate task force composed of members of the North American Securities Administrators Association Inc. ("NASAA"); and

WHEREAS, Morgan Stanley has cooperated with regulators conducting the investigations by responding to inquiries, providing documentary evidence and other materials, and providing regulators with access to facts relating to the investigations; and

WHEREAS, Morgan Stanley has advised regulators of its agreement to resolve the investigations relating to its marketing and sale of ARS to retail investors; and

WHEREAS, Morgan Stanley agrees to, among other things, reimburse certain purchasers of auction rate securities, implement certain changes with respect to its marketing and sale of ARS, and make certain payments; and

WHEREAS, Morgan Stanley elects to permanently waive any right to a hearing and appeal under Section 8-6-25 Code of Alabama 1975 with respect to this Administrative Consent Order (the "Order");

WHEREAS, Morgan Stanley admits the jurisdiction of Alabama Securities Commission ("Commission"), the Commission acknowledges, without admitting or denying the truth thereof,

1 that the following allegations contained in the Notice of Hearing shall be adopted as the
2 Commission's Findings of Fact; and consents to the entry of this Order by the Commission:

3 NOW, THEREFORE, the Commission, as administrator of the Title 8, Chapter 6, Code of
4 Alabama 1975, the Alabama Securities Act ("Act") hereby enters this order:

5 I.

6 **FINDINGS OF FACT**

7 **Unethical Practices in the Offer and Sale of Auction Rate Securities**

8 1. Auction rate securities are financial instruments that include auction-preferred
9 shares of closed-end funds, municipal auction rate bonds, and various asset-backed auction rate
10 bonds (collectively referred to herein as "ARS"). ARS are long-term instruments where the
11 interest/dividend is reset weekly or monthly.

12 2. Morgan Stanley participated in the marketing and sale of ARS.

13 3. In certain instances, Morgan Stanley, through its salespeople, advised certain clients
14 that ARS were safe, liquid investments, when in fact auction rate securities had significant liquidity
15 risks associated with them.

16 4. Representatives of Morgan Stanley represented to certain customers of Morgan
17 Stanley that ARS were short-term investments. In fact, because ARS are bonds with long-term
18 maturities, their short-term liquidity was dependent on the successful operation of a bidding
19 process known as a Dutch auction. Certain representatives of Morgan Stanley failed to disclose to
20 certain customers with short-term liquidity needs that they might be unable to sell their ARS if the
21 auction process failed.

22 5. In connection with the sale of ARS, certain Morgan Stanley salespeople told certain
23 investors that ARS were "just like cash" and "liquid with seven days notice."

24 6. Morgan Stanley marketed ARS to investors within a brochure entitled "Money
25 Market Instruments." Within this brochure, ARS are listed under the subsection "Other Short-
26 Term Instruments."

1 7. Since it began participating in the auction rate securities market, Morgan Stanley
2 submitted support bids—purchase orders for the entirety of an auction rate security issue for which
3 it acted as the sole or lead broker. Support bids were Morgan Stanley proprietary orders that would
4 be filled, in whole or in part, if there was otherwise insufficient demand in an auction. When
5 Morgan Stanley purchased auction rate securities through support bids, auction rate securities were
6 then owned by Morgan Stanley and the holdings were recorded on Morgan Stanley's balance sheet.
7 For risk management purposes, Morgan Stanley imposed limits on the amounts of auction rate
8 securities it could hold in inventory.

9 8. Because many investors could not ascertain how much of an auction was filled
10 through Morgan Stanley proprietary trades, they could not determine if auctions at Morgan Stanley
11 were clearing because of normal marketplace demand, or because Morgan Stanley was making up
12 for the lack of demand through support bids. Generally, investors were also not aware that the
13 liquidity of the auction rate securities as to which Morgan Stanley was the managing broker-dealer
14 depended upon Morgan Stanley's continued use of support bids. While Morgan Stanley could
15 track its own inventory as a measure of the supply and demand for its auction rate securities,
16 ordinary investors had no comparable ability to assess the operation of Morgan Stanley's auctions.
17 There was no way for such investors to monitor supply and demand in the market or to assess when
18 broker-dealers might decide to stop supporting the market, thereby causing its collapse.

19 9. Starting in August 2007, the credit crisis and other deteriorating market conditions
20 strained the auction rate securities market. Some institutional investors withdrew from the market,
21 decreasing demand for auction rate securities.

22 10. The resulting market dislocation should have been evident to Morgan Stanley.
23 Morgan Stanley's support bids filled the increasing gap in the demand in its auctions for auction
24 rate securities, sustaining the impression that the demand for auction rate securities had not
25 decreased. As a result, Morgan Stanley's auction rate securities inventory grew significantly,
26

1 requiring Morgan Stanley to raise its risk management limits on its auction rate securities
2 inventory.

3 11. From the Fall of 2007 through February of 2008, demand for auction rate securities
4 continued to erode and Morgan Stanley's auction rate securities inventory reached unprecedented
5 levels. Morgan Stanley eventually became aware of the increasing strains in the auction rate
6 securities market, and recognized the potential for widespread market failure. Morgan Stanley
7 never disclosed these increasing risks of owning or purchasing auction rate securities to its
8 customers.

9 12. In February 2008, Morgan Stanley and other firms stopped supporting the auctions.
10 Without the benefit of support bids, the auction rate securities market collapsed, leaving investors
11 who had been led to believe that these securities were cash alternative investments appropriate for
12 managing short-term cash needs, holding long-term or perpetual securities that could not be sold at
13 par value until and if the auctions cleared again.

14 Failure to Supervise

15 13. Although ARS are complex products, Morgan Stanley did not provide its sales or
16 marketing staff with the training necessary to adequately explain these products or the mechanics
17 of the auction process to their customers.

18 14. Morgan Stanley did not adequately train all of its brokers and financial advisers
19 regarding the potential illiquidity of ARS, including the fact that Morgan Stanley may stop
20 supporting the market.

21 II.

22 CONCLUSIONS OF LAW

23 15. The Commission has jurisdiction over this matter pursuant to Section 8-6-3 and 8-6-
24 4, Code of Alabama 1975, the Alabama Securities Act.

25 16. The Commission finds that the above conduct subjects Morgan Stanley to sanctions
26 under Section 8-6-3 (j) (7), Code of Alabama 1975, the Alabama Securities Act.

1 17. The Commission finds the following relief appropriate and in the public interest.

2 **III.**

3 **ORDER**

4 On the basis of the Findings of Fact, Conclusions of Law, and Morgan Stanley's consent to
5 the entry of this Order, for the sole purpose of settling this matter prior to a hearing and without
6 admitting or denying the Findings of Fact or Conclusions of Law,

7 **IT IS HEREBY ORDERED:**

8 1. This Order concludes the investigation by the Commission and any other action that
9 the Commission could commence under applicable Alabama law on behalf of Alabama as it relates
10 to Morgan Stanley's marketing and sale of auction rate securities to Morgan Stanley's Retail ARS
11 Investors, as defined below. Specifically excluded from and not covered by this paragraph are any
12 claims by the Commission arising from or relating to the Order provisions contained herein.

13 2. This Order is entered into solely for the purpose of resolving the investigation into
14 Morgan Stanley's marketing and sale of auction rate securities, and is not intended to be used for
15 any other purpose.

16 3. This Order shall be binding upon Respondent Morgan Stanley and its successors
17 and assigns as well as to successors and assigns of relevant affiliates with respect to all conduct
18 subject to the provisions above and all future obligations, responsibilities, undertakings,
19 commitments, limitations, restrictions, events, and conditions.

20 4. Morgan Stanley shall cease and desist from violating the Code of Alabama 1975,
21 Alabama Securities Act, and will comply with the Act.

22 5. Morgan Stanley shall pay the aggregate sum of \$35 million dollars to participating
23 jurisdictions.

24 6. Within ten (10) calendar days following the entry of this Order, Morgan Stanley
25 shall pay to the state of Alabama the sum of \$209,036.21, which amount constitutes Alabama's
26 allocated share of the total settlement payment described in the preceding paragraph. Those funds

1 shall be paid in two (2) separate checks as follows: 1.) Respondents shall pay \$200,000.00 to the
2 to the Alabama Securities Commission as reimbursement of direct and indirect costs and expenses
3 of the Commission's cost for investigating this matter in accordance with Section 8-6-19 (k) (1),
4 Code of Alabama 1975; 2.) Respondents shall pay \$9,036.21 to the Investor Protection Trust, a
5 non-profit corporation and such funds are designated specifically for investor education and
6 investor protection in the state of Alabama as directed by the Alabama Securities Commission in
7 its sole discretion. All checks shall be delivered to the office of the Alabama Securities
8 Commission.

9 7. In the event another state securities regulator determines not to accept Morgan
10 Stanley's settlement offer, the total amount of the payment to the state of Alabama shall not be
11 affected.

12 **Requirement to Repurchase ARS from Retail ARS Investors**

13 8. Morgan Stanley shall provide liquidity to Retail ARS Investors by buying-back, at
14 par, in the manner described below, Eligible ARS that were not clearing as of September 30, 2008.

15 9. "Eligible ARS," for the purposes of this Order, shall mean auction rate securities
16 purchased at Morgan Stanley prior to February 13, 2008.

17 10. "Retail ARS Investors," for the purposes of this Order, shall mean:

18 i. Natural persons (including their IRA accounts, testamentary trust and estate
19 accounts, custodian UGMA and UTMA accounts, and guardianship accounts) who
20 purchased Eligible ARS at Morgan Stanley;

21 ii. Charities and nonprofits with Internal Revenue Code Section 501(c)(3)
22 status that purchased Eligible ARS at Morgan Stanley; and

23 iii. Small Businesses that purchased Eligible ARS at Morgan Stanley. For
24 purposes of this provision, "Small Businesses" shall mean Morgan Stanley customers not
25 otherwise covered in paragraph 10(i) and (ii) above that had \$10 million or less in assets in
26 their accounts with Morgan Stanley, net of margin loans, as determined by the customer's

1 aggregate household position(s) at Morgan Stanley as of August 31, 2008, or, if the
2 customer was not a customer of Morgan Stanley as of August 31, 2008, as of the date that
3 the customer terminated its customer relationship with Morgan Stanley. Notwithstanding
4 any other provision, "Small Businesses" does not include broker-dealers or banks acting as
5 conduits for their customers.

6 11. Morgan Stanley shall offer to purchase, at par plus accrued and unpaid
7 dividends/interest, from Retail ARS Investors their Eligible ARS that were not clearing as of
8 September 30, 2008 ("Buyback Offer"), and explain to such Retail ARS Investors what they must
9 do to accept, in whole or in part, the Buyback Offer. The Buyback Offer shall remain open until at
10 least January 11, 2009 ("Offer Period"). Morgan Stanley may in its sole discretion extend the
11 Offer Period beyond this date.

12 12. Morgan Stanley shall have undertaken its best efforts to identify and provide notice
13 to Retail ARS Investors who invested in Eligible ARS that were not clearing as of September 30,
14 2008, of the relevant terms of this Order by October 20, 2008.

15 13. Retail ARS Investors may accept the Buyback Offer by notifying Morgan Stanley at
16 any time before midnight, Eastern Time, January 11, 2009, or such later date and time as Morgan
17 Stanley may in its sole discretion decide to extend the Offer Period. For Retail ARS Investors who
18 accept the Buyback Offer prior to December 11, 2008, Morgan Stanley shall have purchased their
19 Eligible ARS by December 15, 2008. Morgan Stanley shall have purchased the Eligible ARS of all
20 other Retail ARS Investors who accept the Buyback Offer within the Offer Period, on or before
21 January 16, 2009.

22 14. If at any time between January 12, 2009, and December 31, 2009, a Retail ARS
23 Investor who did not accept the Buyback Offer contacts Morgan Stanley and affirms that he or she
24 did not receive notice of the Buyback Offer prior to January 11, 2009, Morgan Stanley will
25 purchase the Eligible ARS of such investor.

1 15. No later than October 20, 2008, Morgan Stanley shall have established: a) a
2 dedicated toll-free telephone assistance line, with appropriate staffing, to provide information and
3 to respond to questions concerning the terms of this Order; and b) a public Internet page on its
4 corporate Web site(s), with a prominent link to that page appearing on Morgan Stanley's relevant
5 homepage(s), to provide information concerning the terms of this Order and, via reasonable means,
6 to respond to questions concerning the terms of this Order. Morgan Stanley shall maintain the
7 telephone assistance line and Internet page through December 31, 2009.

8 **Review of Customer Accounts**

9 16. For a period of two years from the date of this Order, upon request from any firm
10 that is repurchasing auction rate securities, Morgan Stanley shall take reasonable steps to provide
11 notice of that firm's offer to repurchase auction rate securities to Morgan Stanley customers that
12 Morgan Stanley can reasonably identify, that hold such auction rate securities subject to the other
13 firm's repurchase.

14 **Relief for Investors Who Sold Below Par**

15 17. No later than December 11, 2008, Morgan Stanley shall pay any Retail ARS
16 Investor that Morgan Stanley can reasonably identify who sold Eligible ARS below par between
17 February 13, 2008, and August 13, 2008, the difference between par and the price at which the
18 Retail ARS investor sold the Eligible ARS.

19 **Claims for Consequential Damages**

20 18. Notwithstanding this Order, an investor may pursue any claims related to the sale of
21 auction rate securities via any method normally available to the investor. However, if the investor
22 is pursuing claims related exclusively to consequential damages, Morgan Stanley shall provide the
23 investor with the option to proceed in arbitration according to the following provisions:

- 24 a. The arbitrations will be conducted by a single public arbitrator in accordance
25 with FINRA's special arbitration procedures for claims of consequential damages filed by
26 Retail ARS Investors;

1 b. Morgan Stanley shall pay all applicable FINRA forum and FINRA filing
2 fees;

3 c. Any Morgan Stanley Retail ARS Investors who choose to pursue such
4 claims shall bear the burden of proving that they suffered consequential damages and that
5 such damages were caused by the investors' inability to access funds consisting of Eligible
6 ARS holdings purchased at Morgan Stanley; and

7 d. Morgan Stanley shall be able to defend itself against such claims; provided,
8 however, that Morgan Stanley shall not contest liability related to the sale of auction rate
9 securities, and provided further that Morgan Stanley shall not be able to use as part of its
10 defense a Morgan Stanley Retail ARS Investor's decision not to borrow money from
11 Morgan Stanley.

12 19. Retail ARS Investors who elect to use the special arbitration process provided for
13 herein shall not be eligible for punitive damages.

14 20. All customers, including but not limited to Retail ARS Investors who avail
15 themselves of the relief provided pursuant to this Order, may pursue any remedies against Morgan
16 Stanley available under the law. However, Eligible Investors that elect to utilize the special
17 arbitration process set forth above are limited to the remedies available in that process and may not
18 bring or pursue a claim against Morgan Stanley or in any case where Morgan Stanley is
19 underwriter relating to Eligible ARS in another forum.

20 **Institutional Investors**

21 21. Morgan Stanley shall endeavor to work with issuers and other interested parties,
22 including regulatory and governmental entities, to expeditiously provide liquidity solutions for
23 institutional investors that purchased auction rate securities not covered by the Retail ARS Investor
24 repurchase provisions delineated above.

25 22. Beginning December 11, 2008, and within 45 days of the end of each quarter
26 thereafter, Morgan Stanley shall submit a written report to a representative specified by NASAA

1 outlining the efforts in which Morgan Stanley has engaged and the results of those efforts with
2 respect to Morgan Stanley institutional investors' holdings in Eligible ARS. Morgan Stanley shall,
3 at the option of the representative specified by NASAA, confer with such representative no less
4 frequently than quarterly to discuss Morgan Stanley's progress. Such quarterly meetings shall
5 continue until no later than December 2009. Following every quarterly meeting, the representative
6 shall advise Morgan Stanley of any concerns and, in response, Morgan Stanley shall detail the
7 steps that Morgan Stanley plans to implement to address such concerns. The reporting or meeting
8 deadlines set forth above may be amended upon Morgan Stanley's request if written permission is
9 received from the representative specified by NASAA.

10 **Relief for Municipal Issuers**

11 23. Morgan Stanley shall promptly refund to municipal issuers refinancing fees the
12 issuers paid to Morgan Stanley for the refinancing of their auction rate securities, where such
13 refinancing occurred between February 11, 2008, and the date of this Order and where Morgan
14 Stanley acted as underwriter for the primary offering of the auction rate securities between August
15 1, 2007, and February 11, 2008. Nothing in this Order precludes the Commission from pursuing
16 any other civil action that may arise with regard to auction rate securities other than the marketing
17 and sale of auction rate securities to retail investors.

18 **Additional Considerations**

19 24. Nothing herein shall preclude Alabama, its departments, agencies, boards,
20 commissions, authorities, political subdivisions and corporations (collectively, "State Entities"),
21 other than the Commission and only to the extent set forth in paragraph 1 above, and the officers,
22 agents or employees of State Entities from asserting any claims, causes of action, or applications
23 for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive
24 relief against Morgan Stanley in connection with certain auction rate securities practices at Morgan
25 Stanley.

1 25. This Order shall not disqualify Morgan Stanley or any of its affiliates or current or
2 former employees from any business that they otherwise are qualified or licensed to perform under
3 applicable state law and this Order is not intended to form the basis for any disqualification.

4 26. To the extent applicable, this Order hereby waives any disqualification from relying
5 upon the registration exemptions or registration safe harbor provisions that may be contained in the
6 federal securities laws, the rules and regulations thereunder, the rules and regulations of self
7 regulatory organizations or any states' or U.S. Territories' securities laws. In addition, this Order is
8 not intended to form the basis for any such disqualifications. In addition, this Order is not intended
9 to form the basis of a statutory disqualification under Section 3(a)(39) of the Securities Exchange
10 Act of 1934.

11 27. This Order and any dispute related thereto shall be construed and enforced in
12 accordance with, and governed by, the laws of the state of Alabama without regard to any choice of
13 law principles.

14 28. Evidence of a violation of this Order proven in a court of competent jurisdiction
15 shall constitute prima facie proof of a violation of the Act, in any civil action or proceeding
16 hereafter commenced by the Commission against Morgan Stanley.

17 29. Should the Commission prove in a court of competent jurisdiction that a material
18 breach of this Order by Morgan Stanley has occurred, Morgan Stanley shall pay to the
19 Commission the cost, if any, of such determination and of enforcing this Order including without
20 limitation legal fees, expenses, and court costs.

21 30. If Morgan Stanley fails to make the payment specified in paragraph 6, the
22 Commission may, at its sole discretion, pursue any legal remedies, including but not limited to
23 initiating an action to enforce the Order, revoking Morgan Stanley's registration within the state, or
24 terminating this Order.

25 31. If in any proceeding, after notice and opportunity for a hearing, a court of competent
26 jurisdiction, including an administrative proceeding by a state securities administrator, finds that

1 there was a material breach of this Order, the Commission, at its sole discretion, may terminate the
2 Order. If Morgan Stanley defaults on any other obligation under this Order, the Commission may,
3 at its sole discretion, pursue legal remedies to enforce the Order or pursue an administrative action,
4 including but not limited an action to revoke Morgan Stanley's registration within the state.
5 Morgan Stanley agrees that any statute of limitations or other time related defenses applicable to
6 the subject of the Order and any claims arising from or relating thereto are tolled from and after the
7 date of this Order. In the event of such termination, Morgan Stanley expressly agrees and
8 acknowledges that this Order shall in no way bar or otherwise preclude the Commission from
9 commencing, conducting or prosecuting any investigation, action, or proceeding, however
10 denominated, related to the Order, against Morgan Stanley, or from using in any way any
11 statements, documents or other materials produced or provided by Morgan Stanley prior to or after
12 the date of this Order, including, without limitation, such statements, documents or other materials,
13 if any, provided for purposes of settlement negotiations, except as may otherwise be provided in a
14 written agreement with the Commission.

15 32. Morgan Stanley shall cooperate fully and promptly with the Commission and shall
16 use its best efforts to ensure that all the current and former officers, directors, trustees, agents,
17 members, partners, and employees of Morgan Stanley (and of any of Morgan Stanley's parent
18 companies, subsidiaries, or affiliates) cooperate fully and promptly with the Commission in any
19 pending or subsequently initiated investigation, litigation, or other proceeding relating to auction
20 rate securities and/or the subject matter of the Order. Such cooperation shall include, without
21 limitation, and on a best efforts basis:

22 a. production, voluntarily and without service of subpoena, upon the request of
23 the Commission, of all documents or other tangible evidence requested by the
24 Commission and any compilations or summaries of information or data that the
25 Commission requests that Morgan Stanley (or the Morgan Stanley's parent companies,
26

1 subsidiaries, or affiliates) prepare, except to the extent such production would require the
2 disclosure of information protected by the attorney-client and/or work product privileges;

3 b. without the necessity of a subpoena, having the current (and making all
4 reasonable efforts to cause the former) officers, directors, trustees, agents, members,
5 partners, and employees of Morgan Stanley (and of any of the Morgan Stanley's parent
6 companies, subsidiaries, or affiliates) attend any Proceedings (as hereinafter defined) in
7 Alabama or elsewhere at which the presence of any such persons is requested by the
8 Commission and having such current (and making all reasonable efforts to cause the
9 former) officers, directors, trustees, agents, members, partners, and employees answer any
10 and all inquiries that may be put by the Commission to any of them at any proceedings or
11 otherwise, except to the extent such production would require the disclosure of information
12 protected by the attorney-client and/or work product privileges. "Proceedings" include, but
13 are not limited to, any meetings, interviews, depositions, hearings, trials, grand jury
14 proceedings, or other proceedings;

15 c. fully, fairly, and truthfully disclosing all information and producing all
16 records and other evidence in its possession, custody, or control (or the possession, custody,
17 or control of the Morgan Stanley parent companies, subsidiaries, or affiliates) relevant to all
18 inquiries made by the Commission concerning the subject matter of the Order, except to
19 the extent such inquiries call for the disclosure of information protected by the attorney-
20 client and/or work product privileges; and


21 d. Making outside counsel reasonably available to provide comprehensive
22 presentations concerning any internal investigation relating to all matters in the Order and
23 to answer questions, except to the extent such presentations or questions call for the
24 disclosure of information protected by the attorney-client and/or work product privileges.

25 33. In the event Morgan Stanley fails to comply with paragraph 32 of the Order, the
26 Commission shall be entitled to specific performance, in addition to any other available remedies.

Dated this 10th day of FEBRUARY, 2010.



BY ORDER OF THE
ALABAMA SECURITIES COMMISSION


JOSEPH P. BORG
DIRECTOR

1 **CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY MORGAN STANLEY & CO.**
2 **INCORPORATED**

3 Morgan Stanley & Co. Incorporated ("Morgan Stanley") hereby acknowledges that it has
4 been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its
5 right to a hearing and appeal in this matter, and has waived the same.

6 Morgan Stanley admits the jurisdiction of the Commission neither admits nor denies the
7 Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order
8 by the Commission as settlement of the issues contained in this Order.

9 Morgan Stanley agrees that it shall not claim, assert, or apply for a tax deduction or tax
10 credit with regard to any state, federal or local tax for any administrative monetary penalty that
11 Morgan Stanley shall pay pursuant to this Order.

12 Morgan Stanley states that no promise of any kind or nature whatsoever was made to it to
13 induce it to enter into this Order and that it has entered into this Order voluntarily.

14 S. Anthony Taggart represents that he/she is Executive Director of Morgan
15 Stanley and that, as such, has been authorized by Morgan Stanley to enter into this Order for and on
16 behalf of Morgan Stanley.

17 Dated this 22 day of January, 2010

18 MORGAN STANLEY & CO. INCORPORATED

19 By: [Signature]

20 Title: Executive Director

21 STATE OF New York)
22 County of New York)

23 SUBSCRIBED AND SWORN TO before me this 22nd day of January, 2010

24 _____
Notary Public

25 My commission expires:

7/9/11

26 YOKO NITTA
Notary Public, State Of New York
No. 01NI6060999 QUEEN'S
Qualified In New York County
Commission Expires July 9, 2011