

STATE OF ALASKA
DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT
DIVISION OF BANKING AND SECURITIES

IN THE MATTER OF:

MORGAN STANLEY & CO.
INCORPORATED (CRD #8209),

Respondent.

ADMINISTRATIVE CONSENT ORDER

ORDER NO: 10-08-S

WHEREAS, Morgan Stanley & Co. Incorporated ("Morgan Stanley") is a broker-dealer registered with the State of Alaska, Department of Commerce, Community, and Economic Development, Division of Banking and Securities ("Division"); 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 ARS, implement certain changes with respect to its marketing and sale of ARS, and make certain payments; and

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

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

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

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

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

4 **II.**

5 **CONCLUSIONS OF LAW**

6 15. The Division has jurisdiction over this matter pursuant to AS 45.55.

7 16. The Division finds that the above conduct subjects Morgan Stanley to sanctions
8 under AS 45.55.025 and AS 45.55.060(b)(1).

9 17. The Division finds the following relief appropriate and in the public interest.

10 **III.**

11 **ORDER**

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

15 IT IS HEREBY ORDERED:

16 1. This Order concludes the investigation by the Division and any other action that the
17 Division could commence under AS 45.55 on behalf of Alaska as it relates to Morgan Stanley's
18 marketing and sale of ARS to Morgan Stanley's Retail ARS Investors, as defined below.
19 Specifically excluded from and not covered by this paragraph are any claims by the Division
20 arising from or relating to the Order provisions contained herein.

21 2. This Order is entered into solely for the purpose of resolving the investigation into
22 Morgan Stanley's marketing and sale of ARS, and is not intended to be used for any other purpose.

23 3. This Order shall be binding upon Respondent Morgan Stanley and its successors
24 and assigns as well as to successors and assigns of relevant affiliates with respect to all conduct

1 subject to the provisions above and all future obligations, responsibilities, undertakings,
2 commitments, limitations, restrictions, events, and conditions.

3 4. Morgan Stanley shall cease and desist from violating the Alaska Securities Act and
4 will comply with the Alaska Securities Act.

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

7 6. Within ten (10) calendar days following the entry of this Order, Morgan Stanley
8 shall pay to the Division the sum of \$87,709.81; such amount to be restricted to the following
9 specific use by the Division: promoting investor education, investor protection, and compliance
10 with securities laws. This amount constitutes Alaska's allocated share of the total settlement
11 payment described in the preceding paragraph.

12 7. In the event another state securities regulator determines not to accept Morgan
13 Stanley's settlement offer, the total amount of the payment to the Division shall not be affected.

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

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

17 9. "Eligible ARS," for the purposes of this Order, shall mean ARS purchased at
18 Morgan Stanley prior to February 13, 2008.

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

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

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

1 iii. Small Businesses that purchased Eligible ARS at Morgan Stanley.
2 For purposes of this provision, "Small Businesses" shall mean Morgan Stanley
3 customers not otherwise covered in paragraph 10(i) and (ii) above that had \$10
4 million or less in assets in their accounts with Morgan Stanley, net of margin loans,
5 as determined by the customer's aggregate household position(s) at Morgan Stanley
6 as of August 31, 2008, or, if the customer was not a customer of Morgan Stanley as
7 of August 31, 2008, as of the date that the customer terminated its customer
8 relationship with Morgan Stanley. Notwithstanding any other provision, "Small
9 Businesses" does not include broker-dealers or banks acting as conduits for their
10 customers.

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

17 12. Morgan Stanley shall have undertaken its best efforts to identify and provide notice
18 to Retail ARS Investors who invested in Eligible ARS that were not clearing as of September 30,
19 2008, of the relevant terms of this Order by October 20, 2008.

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

1 Eligible ARS of all other Retail ARS Investors who accept the Buyback Offer within the Offer
2 Period, on or before January 16, 2009.

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

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

14 **Review of Customer Accounts**

15 16. For a period of two years from the date of this Order, upon request from any firm
16 that is repurchasing ARS, Morgan Stanley shall take reasonable steps to provide notice of that
17 firm's offer to repurchase ARS to Morgan Stanley customers that Morgan Stanley can reasonably
18 identify, that hold such ARS subject to the other firm's repurchase.

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

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

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Claims for Consequential Damages

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

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

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

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

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

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

20. All customers, including but not limited to Retail ARS Investors who avail themselves of the relief provided pursuant to this Order, may pursue any remedies against Morgan Stanley available under the law. However, Retail ARS Investors who elect to utilize the special arbitration process set forth above are limited to the remedies available in that process and may not

1 bring or pursue a claim against Morgan Stanley or in any case where Morgan Stanley is
2 underwriter relating to Eligible ARS in another forum.

3 **Institutional Investors**

4 21. Morgan Stanley shall endeavor to work with issuers and other interested parties,
5 including regulatory and governmental entities, to expeditiously provide liquidity solutions for
6 institutional investors who purchased ARS not covered by the Retail ARS Investor repurchase
7 provisions delineated above.

8 22. Beginning December 11, 2008, and within 45 days of the end of each quarter
9 thereafter, Morgan Stanley shall submit a written report to a representative specified by NASAA
10 outlining the efforts in which Morgan Stanley has engaged and the results of those efforts with
11 respect to Morgan Stanley institutional investors' holdings in Eligible ARS. Morgan Stanley shall,
12 at the option of the representative specified by NASAA, confer with such representative no less
13 frequently than quarterly to discuss Morgan Stanley's progress. Such quarterly meetings shall
14 continue until no later than December 2009. Following every quarterly meeting, the representative
15 shall advise Morgan Stanley of any concerns and, in response, Morgan Stanley shall detail the
16 steps that Morgan Stanley plans to implement to address such concerns. The reporting or meeting
17 deadlines set forth above may be amended upon Morgan Stanley's request if written permission is
18 received from the representative specified by NASAA.

19 **Relief for Municipal Issuers**

20 23. Morgan Stanley shall promptly refund to municipal issuers refinancing fees the
21 issuers paid to Morgan Stanley for the refinancing of their ARS, if such refinancing occurred
22 between February 11, 2008, and the date of this Order and if Morgan Stanley acted as underwriter
23 for the primary offering of the ARS between August 1, 2007, and February 11, 2008. Nothing in
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1 this Order precludes the Division from pursuing any other civil action that may arise with regard to
2 ARS other than the marketing and sale of ARS to retail investors.

3 **Additional Considerations**

4 24. Nothing herein shall preclude the State of Alaska, its departments, agencies, boards,
5 commissions, authorities, political subdivisions and corporations (collectively, "State Entities"),
6 other than the Division and only to the extent set forth in paragraph 1 above, and the officers,
7 agents or employees of State Entities from asserting any claims, causes of action, or applications
8 for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive
9 relief against Morgan Stanley in connection with certain ARS practices at Morgan Stanley.

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

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

20 27. This Order and any dispute related thereto shall be construed and enforced in
21 accordance with, and governed by, the laws of the state of Alaska without regard to any choice of
22 law principles.

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1 28. Evidence of a violation of this Order proven in a court of competent jurisdiction
2 shall constitute prima facie proof of a violation of AS 45.55 in any civil action or proceeding
3 hereafter commenced by the Division against Morgan Stanley.

4 29. Should the Division prove in a court of competent jurisdiction that a material breach
5 of this Order by Morgan Stanley has occurred, Morgan Stanley shall pay to the Division the cost, if
6 any, of such determination and of enforcing this Order including without limitation legal fees,
7 expenses, and court costs.

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

12 31. If in any proceeding, after notice and opportunity for a hearing, a court of
13 competent jurisdiction or an administrative proceeding by a state securities administrator finds that
14 there was a material breach of this Order, the Division, at its sole discretion, may terminate the
15 Order. If Morgan Stanley defaults on any other obligation under this Order, the Division may, at
16 its sole discretion, pursue legal remedies to enforce the Order or pursue an administrative action,
17 including but not limited to an action to revoke Morgan Stanley's registration within the state.
18 Morgan Stanley agrees that any statute of limitations or other time related defenses applicable to
19 the subject of the Order and any claims arising from or relating thereto are tolled from and after the
20 date of this Order. In the event of such termination, Morgan Stanley expressly agrees and
21 acknowledges that this Order shall in no way bar or otherwise preclude the Division from
22 commencing, conducting, or prosecuting any investigation, action, or proceeding, however
23 denominated, related to the Order, against Morgan Stanley, or from using in any way any
24 statements, documents, or other materials produced or provided by Morgan Stanley prior to or

1 after the date of this Order, including, without limitation, such statements, documents, or other
2 materials, if any, provided for purposes of settlement negotiations, except as may otherwise be
3 provided in a written agreement with the Division.

4 32. Morgan Stanley shall cooperate fully and promptly with the Division and shall use
5 its best efforts to ensure that all the current and former officers, directors, trustees, agents,
6 members, partners, and employees of Morgan Stanley (and of any of Morgan Stanley's parent
7 companies, subsidiaries, or affiliates) cooperate fully and promptly with the Division in any
8 pending or subsequently initiated investigation, litigation, or other proceeding relating to ARS
9 and/or the subject matter of the Order. Such cooperation shall include, without limitation, and on a
10 best efforts basis:

11 a. production, voluntarily and without service of subpoena, upon the request of
12 the Division, of all documents or other tangible evidence requested by the Division and any
13 compilations or summaries of information or data that the Division requests that Morgan Stanley
14 (or the Morgan Stanley's parent companies, subsidiaries, or affiliates) prepare, except to the extent
15 such production would require the disclosure of information protected by the attorney-client and/or
16 work product privileges;

17 b. without the necessity of a subpoena, having the current (and making all
18 reasonable efforts to cause the former) officers, directors, trustees, agents, members, partners, and
19 employees of Morgan Stanley (and of any of the Morgan Stanley's parent companies, subsidiaries,
20 or affiliates) attend any Proceedings (as hereinafter defined) in Alaska or elsewhere at which the
21 presence of any such persons is requested by the Division and having such current (and making all
22 reasonable efforts to cause the former) officers, directors, trustees, agents, members, partners, and
23 employees answer any and all inquiries that may be put by the Division to any of them at any
24 proceedings or otherwise, except to the extent such production would require the disclosure of

1 information protected by the attorney-client and/or work product privileges. "Proceedings"
2 include, but are not limited to, any meetings, interviews, depositions, hearings, trials, grand jury
3 proceedings, or other proceedings;

4 c. fully, fairly, and truthfully disclosing all information and producing all
5 records and other evidence in its possession, custody, or control (or the possession, custody, or
6 control of the Morgan Stanley parent companies, subsidiaries, or affiliates) relevant to all inquiries
7 made by the Division concerning the subject matter of the Order, except to the extent such
8 inquiries call for the disclosure of information protected by the attorney-client and/or work product
9 privileges; and

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

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

16 SO ORDERED this 28 day of January, 2010. 2011 LLH

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18 State of Alaska
19 Department of Commerce, Community, and
20 Economic Development
21 Division of Banking and Securities

22 /s/ Lorie L. Hovanec

23 By: Lorie L. Hovanec, 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 Division, neither admits nor denies the
7 Findings of Fact and Conclusions of Law contained in this Order, and consents to entry of this
8 Order by the Division 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 payment that Morgan Stanley shall make
11 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
16 on behalf of Morgan Stanley.

17 Dated this 10 day of January, 2010¹

18 MORGAN STANLEY & CO. INCORPORATED

19 By /s/ S. Anthony Taggart

20 Title: Executive Director

21 SUBSCRIBED AND SWORN TO before me this 10 day of January, 2010¹

22 /s/ Yoko Nitta

23 Notary Public for State of New York
24 My commission expires: 07/09/11