

1 Michael Winsor
2 Montana State Auditor's Office
3 840 Helena Avenue
4 Helena, Montana 59601
5 (406) 444-2040

6 Attorney for the Department of Securities

7 **BEFORE THE COMMISSIONER OF SECURITIES AND INSURANCE**
8 **STATE AUDITOR'S OFFICE**
9 **STATE OF MONTANA**

10 In the matter of)

11 **MORGAN STANLEY & CO.**)
12 **INCORPORATED (CRD #8209)**)

13 Respondent.)

14 Case No. SEC-2009-79

15 **CONSENT AGREEMENT AND FINAL**
16 **ORDER**

17 _____)
18 CONSENT AGREEMENT dated this 11 day of December, 2009,

19 between the Montana Securities Department ("Department"), acting pursuant to the authority of the
20 Securities Act of Montana, Mont. Code Ann. § 30-10-101, *et seq.* and Mont. Code Ann. § 2-4-603,
21 and Morgan Stanley & Co. Incorporated ("Morgan Stanley").

22 WHEREAS, Morgan Stanley is a broker-dealer registered in the state of Montana; and

23 WHEREAS, coordinated investigations of the activities of Morgan Stanley in connection
24 with the marketing and sale of auction rate securities ("ARS") have been conducted by a multistate
25 task force composed of members of the North American Securities Administrators Association Inc.
26 ("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

1 maturities, their short-term liquidity was dependent on the successful operation of a bidding
2 process known as a Dutch auction. Certain representatives of Morgan Stanley failed to disclose to
3 certain customers with short-term liquidity needs that they might be unable to sell their ARS if the
4 auction process failed.

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

7 6. Morgan Stanley marketed ARS to investors within a brochure entitled “Money
8 Market Instruments.” Within this brochure, ARS are listed under the subsection “Other Short-
9 Term Instruments.”

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

18 8. Because many investors could not ascertain how much of an auction was filled
19 through Morgan Stanley proprietary trades, they could not determine if auctions at Morgan Stanley
20 were clearing because of normal marketplace demand, or because Morgan Stanley was making up
21 for the lack of demand through support bids. Generally, investors were also not aware that the
22 liquidity of the auction rate securities as to which Morgan Stanley was the managing broker-dealer
23 depended upon Morgan Stanley's continued use of support bids. While Morgan Stanley could track
24 its own inventory as a measure of the supply and demand for its auction rate securities, ordinary
25 investors had no comparable ability to assess the operation of Morgan Stanley's auctions. There
26

1 was no way for such investors to monitor supply and demand in the market or to assess when
2 broker-dealers might decide to stop supporting the market, thereby causing its collapse.

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

6 10. The resulting market dislocation should have been evident to Morgan Stanley.
7 Morgan Stanley's support bids filled the increasing gap in the demand in its auctions for auction
8 rate securities, sustaining the impression that the demand for auction rate securities had not
9 decreased. As a result, Morgan Stanley's auction rate securities inventory grew significantly,
10 requiring Morgan Stanley to raise its risk management limits on its auction rate securities
11 inventory.

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

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

23 **Failure to Supervise**

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

1 to Morgan Stanley's marketing and sale of auction rate securities to Morgan Stanley's Retail ARS
2 Investors, as defined below. Specifically excluded from and not covered by this paragraph are any
3 claims by the Department arising from or relating to the Order provisions contained herein.

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

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

11 4. Morgan Stanley shall cease and desist from violating Mont. Code Ann. §§ 30-10-
12 201(13)(g) and 30-10-201(13)(k) and will comply with the Securities Act of Montana.

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

15 6. Within ten (10) calendar days following the entry of this Order, Morgan Stanley
16 shall pay to the State of Montana and the Investor Protection Trust the sum of \$132,147.28, which
17 amount constitutes Montana's allocated share of the total settlement payment described in the
18 preceding paragraph. Of Montana's allocated share described in the preceding sentence Morgan
19 Stanley shall pay (a) \$120,000.00 to the State of Montana, payment shall be sent to the State
20 Auditor's Office, attention to Michael Winsor, 840 Helena Avenue, Helena, Montana 59601 (to be
21 deposited into the general fund); (b) \$12,147.28 to the Investor Protection Trust, sent to IPT,
22 attention to Don Blandin, Suite 300, 919 Eighteenth Street NW, Washington DC 20006-5517 (for
23 investor education).

24 7. In the event another state securities regulator determines not to accept Morgan
25 Stanley's settlement offer, the total amount of the payment to the state of Montana shall not be
26 affected.

1 Morgan Stanley can reasonably identify, that hold such auction rate securities subject to the other
2 firm's repurchase.

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

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

8 **Claims for Consequential Damages**

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

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

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

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

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

1 27. This Order and any dispute related thereto shall be construed and enforced in
2 accordance with, and governed by, the laws of the state of Montana without regard to any choice of
3 law principles.

4 28. Evidence of a violation of this Order proven in a court of competent jurisdiction
5 shall constitute prima facie proof of a violation of the Securities Act of Montana in any civil action
6 or proceeding hereafter commenced by the Department against Morgan Stanley.

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

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

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

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

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

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

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

1 protected by the attorney-client and/or work product privileges. "Proceedings" include, but
2 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,
6 or control of the Morgan Stanley parent companies, subsidiaries, or affiliates) relevant to all
7 inquiries made by the Department concerning the subject matter of the Order, except to the
8 extent such inquiries call for the disclosure of information protected by the attorney-client
9 and/or work product 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
12 to answer questions, except to the extent such presentations or questions call for the
13 disclosure of 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 Department shall be entitled to specific performance, in addition to any other available remedies.

16 Dated this 11th day of December, 2009.

17 BY ORDER OF MONICA J. LINDEEN
18 Commissioner of Securities and Insurance

19 By: 
20 LYNNE EGAN

21 Deputy Securities Commissioner
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1 **CONSENT TO ENTRY OF CONSENT AGREEMENT AND FINAL ORDER BY**
2 **MORGAN STANLEY & CO. INCORPORATED**

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

6 Morgan Stanley admits the jurisdiction of the Department, 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 Department 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 Taggaet 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 10th day of December, 2009

18 MORGAN STANLEY & CO. INCORPORATED
19 By: [Signature]
20 Title: Executive Director

21 STATE OF New York)
22)
23) :SS
24 County of New York)

25 SUBSCRIBED AND SWORN TO before me this 10th day of December, 2009.

26 [Signature]
(Signature)

Yoko Nitta
(Printed name)

Notary Public for the State of New York
Residing at: QUEENS, NY
My commission expires: 7/9/11