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**STATE OF OREGON
DEPARTMENT OF CONSUMER AND BUSINESS SERVICES
DIVISION OF FINANCE AND CORPORATE SECURITIES
BEFORE THE DIRECTOR OF THE
DEPARTMENT OF CONSUMER AND BUSINESS SERVICES**

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In the Matter of:

File No. S-09-0060

**Morgan Stanley & Co. Incorporated
(CRD#8209),**

**ORDER TO CEASE AND DESIST,
ORDER ASSESSING CIVIL PENALTY,
AND CONSENT TO ENTRY OF ORDER**

Respondent.

WHEREAS, Morgan Stanley & Co. Incorporated ("Morgan Stanley") is a broker-dealer licensed in Oregon; 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 terms, reimburse certain purchasers of ARS, 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 ORS 59.295, ORS 59.305, and ORS Chapter 183 with respect to this Order to Cease and Desist, Order Assessing Civil Penalty, and Consent to Entry of Order (the "Order");

WHEREAS, Morgan Stanley admits the jurisdiction of the Director of the Department of

Division of Finance and Corporate Securities
Labor and Industries Building
350 Winter Street NE, Suite 410
Salem, OR 97301-3881
Telephone: (503) 378-4387



1 Consumer and Business Services (“the Director”); acknowledges, without admitting or denying
2 the truth thereof, that the following allegations contained in the Order shall be adopted as the
3 Director’s Findings of Fact and Conclusions of Law; and consents to the entry of this Order by
4 the Director:

5 NOW, THEREFORE, the Director, as administrator of the Oregon Securities Law, ORS
6 Chapter 59 and OAR Chapter 441, hereby enters this Order:

7 **I.**

8 **FINDINGS OF FACT**

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

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

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

15 3. In certain instances, Morgan Stanley, through its securities salespersons, advised
16 certain investors that ARS were safe, liquid investments, when in fact ARS had significant
17 liquidity risks associated with them.

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

24 5. In connection with the sale of ARS, some of Morgan Stanley’s securities salespersons
25 told certain investors that ARS were “just like cash” and “liquid with seven days notice.”

26 6. Morgan Stanley marketed ARS to investors within a brochure entitled "Money





1 Market Instruments.” Within this brochure, ARS are listed under the subsection "Other Short-
2 Term Instruments."

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

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

21 9. Starting in August 2007, the credit crisis and other deteriorating market conditions
22 strained the ARS market. Some institutional investors withdrew from the market, decreasing
23 demand for ARS.

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



1 Stanley's ARS inventory grew significantly, requiring Morgan Stanley to raise its risk
2 management limits on its ARS inventory.

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

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

13 **Failure to Supervise**

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

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

20 **II.**

21 **CONCLUSIONS OF LAW**

22 1. The Director has jurisdiction over this matter pursuant to ORS 59.235 and ORS
23 59.245.

24 2. The Director finds that the above conduct subjects Morgan Stanley to sanctions for
25 dishonest and unethical business practices, pursuant to ORS 59.205(2), and for failure to
26 supervise, pursuant to ORS 59.205(13).

1 Oregon’s allocated share of the total settlement payment described in the preceding paragraph.
2 The Oregon payment includes a civil penalty of \$243,814.91 (two hundred forty-three thousand,
3 eight hundred fourteen dollars and ninety-one cents) for the General Fund of the Oregon State
4 Treasury, pursuant to ORS 59.995(1), and \$12,832.37 (twelve thousand, eight hundred thirty-two
5 dollars and thirty-seven cents) for the Oregon Department of Consumer and Business Services
6 Consumer Financial Education Account.

7 7. If another state securities regulator determines not to accept Morgan Stanley's
8 settlement offer, the total amount of the payment to Oregon shall not be affected.

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

10 8. Morgan Stanley shall provide liquidity to Retail ARS Investors by buying-back, at
11 par, in the manner described below, Eligible ARS that were not clearing as of September 30,
12 2008.

13 9. “Eligible ARS,” for the purposes of this Order, shall mean ARS purchased at Morgan
14 Stanley prior to February 13, 2008.

15 10. “Retail ARS Investors,” for the purposes of this Order, shall mean:

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

19 B. Charities and nonprofits with Internal Revenue Code Section 501(c)(3) status that
20 purchased Eligible ARS at Morgan Stanley; and

21 C. Small Businesses that purchased Eligible ARS at Morgan Stanley. For purposes of
22 this provision, “Small Businesses” shall mean Morgan Stanley investors not otherwise covered
23 in paragraph 10(A) and (B) above that had \$10 million or less in assets in their accounts with
24 Morgan Stanley, net of margin loans, as determined by the investor’s aggregate household
25 position(s) at Morgan Stanley as of August 31, 2008, or, if the investor was not a customer of
26 Morgan Stanley as of August 31, 2008, as of the date that the customer terminated its customer





1 relationship with Morgan Stanley. Notwithstanding any other provision, “Small Businesses”
2 does not include broker-dealers or banks acting as conduits for their investors.

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

9 12. Morgan Stanley shall have undertaken its best efforts to identify and provide notice to
10 Retail ARS Investors who invested in Eligible ARS that were not clearing as of September 30,
11 2008, of the relevant terms of this Order by October 20, 2008.

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

19 14. If at any time between January 12, 2009, and December 31, 2009, a Retail ARS
20 Investor who did not accept the Buyback Offer contacted Morgan Stanley and affirmed that he or
21 she did not receive notice of the Buyback Offer prior to January 11, 2009, Morgan Stanley will
22 have purchased the Eligible ARS of such investor.

23 15. No later than October 20, 2008, Morgan Stanley shall have established: a) a dedicated
24 toll-free telephone assistance line, with appropriate staffing, to provide information and to
25 respond to questions concerning the terms of this Order; and b) a public Internet page on its
26 corporate Web site(s), with a prominent link to that page appearing on Morgan Stanley’s relevant

1 homepage(s), to provide information concerning the terms of this Order and, via reasonable
2 means, to respond to questions concerning the terms of this Order. Morgan Stanley shall have
3 maintained the telephone assistance line and Internet page through December 31, 2009.

4 **Review of Investor Accounts**

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

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

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

14 **Claims for Consequential Damages**

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

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

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

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





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

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

7 20. All investors, including but not limited to Retail ARS Investors who avail themselves
8 of the relief provided pursuant to this Order, may pursue any remedies against Morgan Stanley
9 available under the law. However, Retail ARS Investors that elect to use the special arbitration
10 process set forth above are limited to the remedies available in that process and may not bring or
11 pursue a claim against Morgan Stanley or in any case where Morgan Stanley is underwriter
12 relating to Eligible ARS in another forum.

13 Institutional Investors

14 21. Morgan Stanley shall endeavor to work with issuers and other interested parties,
15 including regulatory and governmental entities, to expeditiously provide liquidity solutions for
16 institutional investors that purchased ARS not covered by the Retail ARS Investor repurchase
17 provisions delineated above.

18 22. Beginning December 11, 2008, and within 45 days of the end of each quarter
19 thereafter, Morgan Stanley shall have submitted a written report to a representative specified by
20 NASAA outlining the efforts in which Morgan Stanley has engaged and the results of those
21 efforts with respect to Morgan Stanley institutional investors' holdings in Eligible ARS. Morgan
22 Stanley shall, at the option of the representative specified by NASAA, have conferred with such
23 representative no less frequently than quarterly to discuss Morgan Stanley's progress. Such
24 quarterly meetings shall have continued until no later than December 2009. Following every
25 quarterly meeting, the representative shall have advised Morgan Stanley of any concerns and, in
26 response, Morgan Stanley shall have detailed the steps that Morgan Stanley plans to implement

1 to address such concerns. The reporting or meeting deadlines set forth above may be amended
2 upon Morgan Stanley's request if written permission is received from the representative
3 specified by NASAA.

4 **Relief for Municipal Issuers**

5 23. Morgan Stanley shall promptly refund to municipal issuers refinancing fees the
6 issuers paid to Morgan Stanley for the refinancing of their ARS, where such refinancing
7 occurred between February 11, 2008, and the date of this Order and where Morgan Stanley acted
8 as underwriter for the primary offering of the ARS between August 1, 2007, and February 11,
9 2008. Nothing in this Order precludes the Director from pursuing any other civil action that may
10 arise with regard to ARS other than the marketing and sale of ARS to retail investors.

11 **Additional Considerations**

12 24. Nothing herein shall preclude the state of Oregon, its departments, agencies, boards,
13 commissions, authorities, political subdivisions and corporations (collectively, "State Entities"),
14 other than the Director and only to the extent set forth in paragraph 1 above, and the officers,
15 agents or employees of State Entities from asserting any claims, causes of action, or applications
16 for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive
17 relief against Morgan Stanley in connection with certain ARS practices at Morgan Stanley.

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

22 26. To the extent applicable, this Order hereby waives any disqualification from relying
23 upon the registration exemptions or registration safe harbor provisions that may be contained in
24 the federal securities laws, the rules and regulations thereunder, the rules and regulations of self
25 regulatory organizations or any states' or U.S. Territories' securities laws. In addition, this Order
26 is not intended to form the basis for any such disqualifications. In addition, this Order is not





1 intended to form the basis of a statutory disqualification under Section 3(a)(39) of the Securities
2 Exchange Act of 1934.

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

6 28. Evidence of a violation of this Order proven in a court of competent jurisdiction shall
7 constitute prima facie proof of a violation of the Oregon Securities Law, in any civil action or
8 proceeding hereafter commenced by the Director against Morgan Stanley.

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

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

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



1 commencing, conducting or prosecuting any investigation, action, or proceeding, however
2 denominated, related to the Order, against Morgan Stanley, or from using in any way any
3 statements, documents or other materials produced or provided by Morgan Stanley prior to or
4 after the date of this Order, including, without limitation, such statements, documents or other
5 materials, if any, provided for purposes of settlement negotiations, except as may otherwise be
6 provided in a written agreement with the Director.

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

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

20 B. without the necessity of a subpoena, having the current (and making all reasonable
21 efforts to cause the former) officers, directors, trustees, agents, members, partners, and
22 employees of Morgan Stanley (and of any of the Morgan Stanley's parent companies,
23 subsidiaries, or affiliates) attend any Proceedings (as hereinafter defined) in Oregon or
24 elsewhere at which the presence of any such persons is requested by the Director and having
25 such current (and making all reasonable efforts to cause the former) officers, directors, trustees,
26 agents, members, partners, and employees answer any and all inquiries that may be put by the



1 Director to any of them at any proceedings or otherwise, except to the extent such production
2 would require the disclosure of information protected by the attorney-client and/or work product
3 privileges. "Proceedings" include, but are not limited to, any meetings, interviews, depositions,
4 hearings, trials, grand jury proceedings, or other proceedings;

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

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

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

17 Dated this 15th day of November, 2010.

18 CORY STREISINGER, Director
19 Department of Consumer and Business Services

20 By: /s/ David Tatman

21 David C. Tatman, Administrator
22 Division of Finance and Corporate Securities

22 CONSENT TO ENTRY OF ORDER BY MORGAN STANLEY & CO. INCORPORATED

23 Morgan Stanley & Co. Incorporated ("Morgan Stanley") hereby acknowledges that it has
24 been served with a copy of this Order to Cease and Desist, Order Assessing Civil Penalty, and
25 Consent to Entry of Order ("Order"), has read the foregoing Order, is aware of Morgan Stanley's
26 right to a hearing and appeal in this matter, and has waived the same.

Division of Finance and Corporate Securities
Labor and Industries Building
350 Winter Street NE, Suite 410
Salem, OR 97301-3881
Telephone: (503) 378-4387



1 Morgan Stanley admits the jurisdiction of the Director, neither admits nor denies the
2 Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this
3 Order by the Director as settlement of the issues contained in this Order.

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

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

9 S. Anthony Taggart represents that he is Executive Director of Morgan Stanley and that,
10 as such, has been authorized by Morgan Stanley to enter into this Order for and on behalf of
11 Morgan Stanley.

12 Dated this 8th day of November, 2010.

13 MORGAN STANLEY & CO. INCORPORATED

14
15 By: /s/ S Anthony Taggart
16 S. Anthony Taggart, Executive Director

17 STATE OF New York)
18 County of New York)

19 SUBSCRIBED AND SWORN TO before me this 8th day of November, 2010.

20
21 /s/ Yoko Nitta
22 Notary Public

23 Yoko Nitta
(Printed Name of Notary Public)

24 My commission expires:

25 7/9/11

26