

**UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934  
Release No. 56980 / December 18, 2007**

**INVESTMENT COMPANY ACT OF 1940  
Release No. 28078 / December 18, 2007**

**ADMINISTRATIVE PROCEEDING  
File No. 3-12907 / December 18, 2007**

**In the Matter of**

**MORGAN STANLEY & CO.  
INCORPORATED,**

**RESPONDENT**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER PURSUANT TO  
SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTIONS 9(b) AND 9(f) OF THE  
INVESTMENT COMPANY ACT OF 1940**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against Morgan Stanley & Co. Incorporated (“MS&Co” or “Respondent”), as successor to Morgan Stanley DW Inc. (“MSDW”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings

herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"), as set forth below.

### III.

On the basis of this Order and the Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. From at least January 2002 until August 2003, four financial advisors<sup>2</sup> ("FA 1," "FA 2," "FA 3," and "FA 4," or collectively, the "FAs") at three MSDW offices ("Office A," "Office B," and "Office C") engaged in deceptive trading practices designed to circumvent mutual funds' restrictions on market timing.<sup>3</sup>

2. Each of the FAs opened multiple MSDW accounts for their hedge fund customers to facilitate market timing for the hedge funds. In response to market-timing trades, numerous fund companies sent MSDW "block letters," rejecting particular trades or restricting the trading of particular accounts, customers, or financial advisors that appeared to be market timing. Many of the block letters stated that the frequent market-timing trading was harmful to the funds' long-term shareholders. The FAs circumvented the fund companies' restrictions on market timing by employing a variety of deceptive trading practices. These practices included using accounts not restricted by mutual funds to place market-timing trades, trading under different financial advisor identification numbers, and placing market-timing trades through variable annuity contracts. The FAs placed market-timing trades for their hedge fund customers with hundreds of mutual funds and engaged in practices designed to circumvent restrictions the fund companies imposed on market timing. Through these practices, the FAs willfully violated, and/or aided and abetted the violation of, the antifraud provisions of the federal securities laws.

3. MSDW failed reasonably to supervise the FAs with a view to preventing and detecting these violations. MSDW had inadequate policies, procedures, and systems in

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> MSDW refers to its registered brokers as financial advisors.

<sup>3</sup> Market timing includes (a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal *per se*, can harm other mutual fund shareholders because it can dilute the value of their shares if the market timer is exploiting pricing inefficiencies, disrupt the management of the mutual fund's investment portfolio, and can cause the targeted mutual fund to incur costs borne by shareholders to accommodate frequent buying and selling of shares by the market timer.

place to prevent and detect the FAs' misconduct. Beginning in the summer of 2002, MSDW's Mutual Fund Operations Department ("MF Ops"), which oversaw mutual fund trading and dealt directly with fund companies, notified senior MSDW compliance and sales officers that, based on its analysis of complaints from fund companies, it believed the FAs were engaged in deceptive activity on behalf of market-timing customers. In September 2002, MSDW formed a market-timing working group to address market timing by its financial advisors. However, it was not until March 2003, that MSDW implemented an "anti-market-timing" policy. After the policy was implemented, the FAs were still given a "transition" period to cease market-timing activity over an unspecified period of time. MSDW stopped all market timing in August 2003.

4. In addition to failing to reasonably supervise the FAs, MSDW violated Rule 22c-1(a) under the Investment Company Act by allowing MF Ops employees and financial advisors to place, cancel, or amend trades for their hedge fund customers after the market close and receive the same day's NAV. Prior to September 15, 2003, MSDW's mutual fund trading system allowed MF Ops employees to reopen the trading system after 4:00 p.m. ET, at the request of a financial advisor, and place, cancel, or amend trades, or allow the financial advisor to place, cancel, and amend trades, after the 4:00 p.m. ET market close without controls regarding the time of receipt of these new orders from customers.<sup>4</sup>

5. Further, MSDW violated Section 17(a)(1) of the Exchange Act and Rule 17a-3 thereunder by failing to make or keep a record of (1) customer orders financial advisors communicated to MF Ops to place, cancel, or amend trades, and (2) customer orders FA 1, FA 2, and FA 3 received from hedge fund customers to place trades in variable annuity sub-accounts.

6. MSDW profited from the FAs' trading practices by generating approximately \$4,400,000 in commissions and asset-based fees from the FAs' market-timing customers.

### **Respondent**

7. Morgan Stanley & Co. Incorporated is a Delaware corporation with its principal place of business in New York, New York. MS&Co. is a registered broker-dealer with the Commission pursuant to Section 15(b) of the Exchange Act, a member of the Financial Industry Regulatory Authority ("FINRA") (formerly known as the National Association of Securities Dealers("NASD")), the New York Stock Exchange ("NYSE"), and the Municipal Securities Rulemaking Board ("MSRB"). MS&Co. is a wholly owned subsidiary of Morgan Stanley, a Delaware corporation whose common stock trades on the New York Stock Exchange. MS&Co. provides comprehensive brokerage, investment, and financial services nationwide.

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<sup>4</sup> On September 15, 2003, MSDW implemented a policy that required requests to amend trades after 4:00 p.m. to be communicated by email from a branch manager. In December 2003, MSDW implemented a "hard close" at 4:00 p.m. - meaning no trades could be placed after that time at that day's net asset value ("NAV").

8. Morgan Stanley DW Inc., during the relevant time period, was a Delaware corporation with its principal place of business in New York, New York. Also during the relevant time period, MSDW was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, a registered investment adviser pursuant to Section 203(c) of the Investment Advisers Act of 1940, and a member of the NASD, the NYSE, and the MSRB. MSDW was a wholly owned subsidiary of Morgan Stanley until April 1, 2007, when MSDW merged into MS&Co. to form a single broker-dealer. Before the merger, MSDW provided comprehensive brokerage, investment and financial services nationwide.

### **Market-Timing Trades Placed by the FAs**

9. Most of the mutual funds in which the FAs placed market-timing trades either prohibited market timing or limited the number and frequency of trades in an effort to prevent market timing. The mutual funds reserved the right to cancel or reject trades that violated their market-timing policies and attempted to enforce these policies primarily by monitoring the trading associated with a particular account number. Some of the mutual funds monitored trading associated with the financial advisor's identification number. When the funds detected a market-timing trade that violated their policy, they would generally block the trade. In many cases, the funds also blocked all future trades by that account or blocked all future trades in that fund family by the financial advisor associated with the trade. Fund companies informed MSDW by letters or emails, generally referred to as block letters, of the violative trading detected and the action taken. Many of these letters or emails stated that the frequent trading was harmful to the funds' long-term shareholders. These letters and emails were forwarded to the FAs.

10. In order to prevent being detected as a market-timer, or to continue placing market-timing trades once detected, the FAs engaged in a series of trading practices designed to conceal their customers' market-timing activity from fund companies. Each of the FAs engaged in one or more of the following acts or practices: (1) opening several accounts in order to use multiple account numbers for the same hedge fund customer; (2) opening accounts under multiple entity names affiliated with the same hedge fund customer; (3) opening accounts at different branch offices for the same hedge fund customer; (4) placing trades using multiple financial advisor identification numbers for the same hedge fund customer; and (5) assisting the hedge fund customers trade mutual funds through variable annuity sub-accounts. Using variable annuities to trade mutual funds hid market-timing trades because issuers of variable annuities aggregate trades in their contracted fund companies and transmit the trades on a net basis, thereby preventing the underlying fund company from tracking trading by particular customers or by particular financial advisors. By engaging in these trading practices, the FAs willfully violated, and/or aided and abetted violations of, Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Office A

11. FA 1 and FA 2 worked in MSDW's Office A. FA 1 engaged in, and FA 2 substantially assisted FA 1 in engaging in, deceptive market-timing practices on behalf of two hedge fund customers. FA 1 was a financial advisor in Office A from October 2000 to October 2003. FA 2 was a financial advisor in Office A from March 2000 until November 2003. FA 1 placed market-timing trades in mutual funds for one New York-based hedge fund customer from at least January 2002 until July 2003. FA 2 placed market-timing trades for this customer from at least January 2002 through March 2003. FA 1 and FA 2 also placed market-timing trades in mutual funds for another New York-based hedge fund from at least January 2002 through March 2003. Together, they placed over 2,500 market-timing trades for these customers in 2002 and 2003, making FA 1 a top-ten revenue generator in Office A in both 2002 and 2003, and FA 2 a top-ten revenue generator in Office A in 2002.

12. From December 14, 2001 until February 10, 2003, MSDW received over 125 block letters from fund companies attempting to stop FA 1's and FA 2's market-timing trading for the New York hedge fund customers. These block letters were forwarded to FA 1 and FA 2. In order to prevent detection as a market-timer and to continue placing market-timing trades once detected, FA 1 engaged in a series of acts and practices to conceal his customers' market-timing activity from fund companies. FA 2 knowingly and substantially assisted FA 1 in engaging in these acts.

13. For example, FA 1 and FA 2 placed market-timing trades through multiple accounts they opened for customers, including accounts opened in response to block letters. Multiple accounts made it harder for fund companies to monitor trading and allowed the hedge fund customers to reenter funds that had blocked their other accounts. FA 1 and FA 2 opened approximately 59 accounts for one of the New York-based hedge funds and 13 accounts for the other New York based hedge fund in order to circumvent mutual funds' restrictions on market timing. The accounts were opened in the names of multiple entities associated with the hedge funds.

14. FA 1 and FA 2 also placed trades for the hedge fund customers under multiple financial advisor identification numbers to circumvent mutual fund restrictions on market timing, including restrictions imposed by block letters. FA 1 and FA 2 used the financial advisor identification number of a retiring financial advisor to place market-timing trades. They also obtained multiple financial advisor identification numbers through a joint production agreement with a financial advisor in their own office and multiple joint production agreements with a financial advisor in another MSDW office. Identification numbers obtained from the joint production agreements with the financial advisor at the other office facilitated the market-timing activity because trades using those identification numbers contained a branch code prefix not associated with Office A. FA 1 and FA 2 used at least eight different financial advisor identification numbers to place trades for the two hedge fund customers.

15. FA 1 and FA 2 also disguised market-timing trades by assisting their hedge fund customers acquire, and place trades in, variable annuity contracts issued by insurance companies that held mutual funds in their underlying sub-accounts. Because the variable annuity issuers aggregate and transmit trades in their contracted fund companies on a net basis, the fund companies had difficulty identifying trading by particular customers or financial advisors. FA 1 and FA 2 opened approximately 32 variable annuity contracts for the first New York-based hedge fund and 14 for the second New York-based hedge fund in order to enable these customers to market-time the underlying mutual funds.

### Office B

16. FA 3, who worked in MSDW's Office B from August 1998 until March 2004, engaged in deceptive market-timing practices on behalf of a New York-based hedge fund. From April 30, 2002, until August 5, 2003, FA 3 placed over 1,000 market-timing trades in mutual funds for the New York-based hedge fund, making FA 3 the second largest revenue generator in Office B in both 2002 and 2003.

17. From May 21, 2002 until May 28, 2003, MSDW received over 90 block letters from fund companies attempting to stop FA 3's market-timing trading for the New York hedge fund customer. These block letters were forwarded to FA 3. In order to prevent detection as a market-timer and to continue placing market-timing trades once detected, FA 3 engaged in a series of acts and practices to conceal his customers' market-timing activity from fund companies.

18. For example, FA 3 placed market-timing trades through multiple accounts he opened for the New York hedge fund customer, including accounts opened in response to block letters. Multiple accounts made it harder for fund companies to monitor trading and allowed the hedge fund customers to re-enter funds that had blocked their other accounts. In order to prevent detection as a market-timer, and/or to continue placing market-timing trades once detected, FA 3 opened approximately 50 different accounts for this customer. The accounts bore the names of limited liability companies the hedge fund had formed to facilitate market-timing trades and to increase the mutual funds' difficulty in tracking the hedge fund's activity.

19. FA 3 also placed trades for the hedge fund customer under multiple financial advisor identification numbers to circumvent mutual fund restrictions on market timing, including restrictions imposed by block letters. After receiving block letters, FA 3 obtained at least two additional financial advisor identification numbers through a joint production agreement with one other financial advisor in Office B and a joint production agreement with a sales assistant in Office B.

20. FA 3 also disguised market-timing trades by assisting his hedge fund customer in acquiring, and placing trades in, variable annuity contracts from insurance companies that

held mutual funds in their underlying sub-accounts. Because the variable annuity issuers aggregate and transmit trades in their contracted fund companies on a net basis, the fund companies had difficulty identifying trading by particular customers or financial advisors. FA 3 opened approximately 10 variable annuity contracts for the New York-based hedge fund in order to enable this customer to market-time the underlying mutual funds.

### Office C

21. FA 4, who worked in MSDW's Office C from November 1999 until April 2004, engaged in deceptive market-timing practices on behalf of two institutional customers. He placed over 500 market-timing trades for a U.K.-based hedge fund and a Virginia-based money manager. FA 4 placed market-timing trades for the U.K.-based hedge fund from May 2001 until July 18, 2003. He placed market-timing trades for the Virginia-based money manager from at least December 31, 2002 until August 27, 2003. This trading made FA 4 a top ten revenue generator in Office C in both 2002 and 2003.

22. MSDW received over 100 block letters relating to FA 4's trading for these two customers between May 2001 and July 2003. These block letters were forwarded to FA 4. In order to prevent detection as a market-timer, and to continue placing market-timing trades once detected, FA 4 placed market-timing trades in the multiple accounts he had opened for these customers, including accounts opened in response to block letters. Multiple accounts made it harder for fund companies to monitor trading and allowed the hedge fund customers to re-enter funds that had blocked their other accounts. FA 4 opened 30 MSDW accounts for the U.K.-based hedge fund and 14 MSDW accounts for the Virginia-based money manager.

23. MSDW facilitated FA 4's market timing for his customers by manually updating his customers' accounts on trade dates. In the normal course, MSDW's order entry system settled mutual fund trades three days after orders were placed (T+3 settlement). MSDW allowed FA 4 to bypass the system and send his customers' trades directly to MF Ops where his customers' positions would be manually updated to provide next-day settlement for his market-timing trades. The process enabled FA 4's market-timing customers to change their positions one day after placing orders, instead of having to wait three days for orders to settle. This enabled his customers to more easily exploit inefficiencies in mutual fund pricing and allowed the customers to place more market-timing trades.

### **MSDW Failed Reasonably to Supervise the FAs With a View to Preventing their Market-Timing Activity**

24. MSDW failed reasonably to supervise the FAs with a view to preventing and detecting their violations of the federal securities laws. In particular, MSDW failed to adopt, implement, and enforce reasonable supervisory policies, procedures, and systems that could have prevented and detected the FAs' deceptive market-timing activity,

including the practices described above that the FAs engaged in for their customers before MSDW received block letters from mutual funds. In particular, MSDW did not establish procedures and systems for following up on indications that the FAs were using deceptive practices to deceive mutual funds in connection with customers' market-timing trades.

25. From 2001 to 2003, MSDW received over 300 block letters relating to market timing by the FAs. These block letters were generally sent to MF Ops, which then forwarded them to the FAs, their branch managers, MSDW's Compliance Department for the Individual Investor Group ("MSDW Compliance"), and, in some cases, senior officers of MSDW's Investor Advisory Services.

26. Some of the block letters MSDW received complained that prior prohibitions were being ignored and that the FAs were disguising trades to circumvent those prohibitions. For example: (a) a June 13, 2001 letter from one fund company that prohibited any future exchange activity for three accounts for FA 4's U.K.-based hedge fund stated, "Additionally, if you redeem and purchase into a new account, we will immediately place similar restrictions on the new account."; (b) a June 27, 2002 block letter from a fund company stated that a customer of FA 1 and FA 2 had been previously blocked under different account numbers; (c) an October 10, 2002 email from a fund company concerned \$6.2 million in market-timing activity that FA 3 placed under a different financial advisor's identification number "perhaps to try and disguise it;" (d) an October 28, 2002 letter from a fund company blocked all trades from MSDW's Office C because attempts to reject purchases in certain accounts "have not deterred the frequent trading of our funds and (e) a December 5, 2002 email from a fund company listed all the MSDW market-timers it attempted to block in 2002 and identified FA 1, FA 2, and FA 3 as having been blocked repeatedly under different account numbers and financial advisor identification numbers.

27. MF Ops managers concluded that the FAs were disguising market-timing trades in order to circumvent mutual fund market-timing restrictions and notified MSDW compliance and national sales managers on several occasions as follows. No one effectively followed up on these concerns with senior MSDW management or supervisors of the FAs:

a. In the Summer of 2002, the First Vice President of MF Ops (the head of the department), and his direct report, the Vice President of External Mutual Fund Processing ("VP of External Processing") analyzed block letters and identified a pattern of disguising trades. They notified the Deputy Director of MSDW Compliance ("Deputy Director") and the Vice President of External Mutual Fund Marketing ("VP of Marketing") of the pattern and asked them for assistance in stopping the activity. The Deputy Director told them that MSDW needed an internal policy prohibiting the activity in order to take action.

b. On August 8, 2002, the VP of External Processing again notified the Deputy Director by email that from his perspective "it appears multiple [account numbers]



and multiple rep numbers are used to disguise market-timing activity.”

c. On November 12, 2002, the VP of External Processing again wrote to the VP of Marketing that “[a]ctivity at the branch is done to disguise the customer’s action. Multiple accounts are opened including accounts at different branches. Accounts are opened with different FA numbers, partnerships, and individual codings.” The VP of External Processing subsequently identified FA 1, FA 2, FA 3, and FA 4 as having disguised trades to facilitate market timing and met with the Director of MSDW Compliance to stress his concern about the continuing problem of disguised trades.

28. In September 2002, MSDW formed a market-timing working group. In November 2002, the market-timing working group held its first meeting. MF Ops provided the working group with a list of financial advisors and accounts that had received block letters. In a November 29, 2002 memorandum to the committee, MF Ops reiterated its concern that, “Much of the activity at the branch is done to disguise the clients [sic] action. Multiple accounts are opened including accounts at different branches. Accounts are opened with different FA numbers, partnerships and individual codings.” The working group also received an analysis of FA 1’s and FA 2’s trading prepared by a Compliance officer that identified 39 related accounts under five financial advisor identification numbers that placed 296 mutual fund trades in one month alone. At no time were these concerns effectively followed up on with senior MSDW management or supervisors of the FAs.

29. Despite this information, it was not until March 20, 2003, that MSDW issued a market-timing policy. The policy stated that once an account was identified as market timing, it could be closed or restricted to liquidating orders only, and the advisor subjected to reversal of commissions, discipline, or termination. Yet, MSDW implemented no internal system for preventing or detecting deceptive practices regarding market-timing trades; instead, it relied on fund companies to detect and notify MSDW of such activity via block letters. In particular, the policy failed to prohibit the activity that MF Ops alerted the working group was being used to circumvent mutual fund restrictions, including using multiple accounts, multiple financial advisor identification numbers, and variable annuity contracts.

30. Even though the purpose of the market-timing policy was to identify and stop market timing, the FAs were permitted to “transition” out of the business and continue placing trades for their market-timing customers provided the FAs did not receive block letters from mutual funds. In fact, until June 28, 2003, MSDW continued to manually update FA 4’s trades, affording his customers one-day settlement for their mutual fund market-timing activity. Market-timing activity continued until August 2003 – five months after the issuance of the market-timing policy. Also, it took until September 2003 for MSDW to add a function to its mutual fund trading system that allowed MF Ops to place stops on accounts or financial advisor identification numbers reflected in block letters, even though MF Ops had requested that feature a year earlier.

### **MSDW Failed Reasonably to Supervise the FAs**

31. Section 15(b)(4)(E) of the Exchange Act requires broker-dealers reasonably to supervise persons subject to their supervision, with a view toward preventing violations of the federal securities laws. *See e.g., Dean Witter Reynolds, Exchange Act Rel. 46578* (October 1, 2002). The Commission has emphasized that the “responsibility of broker-dealers to supervise their employees by means of effective, established procedures is a critical component in the federal investor protection scheme regulating the securities markets. *Id.* Section 15(b)(4)(E) of the Exchange Act provides for the imposition of a sanction against a broker or dealer who “has failed reasonably to supervise, with a view to preventing violations of the securities laws, another person who commits such a violation, if such other person is subject to his supervision.” The FAs willfully violated or aided and abetted violations of the antifraud provisions of the federal securities laws.

32. As a result of the conduct described above, MSDW failed reasonably to supervise the FAs with a view toward detecting and preventing their violations of the federal securities laws, within the meaning of Section 15(b)(4)(E).

### **MSDW Violated Investment Company Act Rule 22c-1(a)**

33. Rule 22c-1(a) under the Investment Company Act requires investment companies issuing redeemable securities, their principal underwriters and dealers, and any person designated in the fund’s prospectus as authorized to consummate transactions in securities issued by the fund to sell and redeem fund shares at a price based on the current net asset value (“NAV”) next computed after receipt of an order to buy or redeem. Mutual funds generally determine the daily price of mutual fund shares as of 4:00 p.m. ET. In these circumstances, orders received by 4:00 p.m. ET must be executed at the price determined as of 4:00 p.m. ET that day. Orders received after 4:00 p.m. ET must be executed at the price determined as of 4:00 p.m. ET the next trading day.

34. From January 2000 until September 15, 2003, at the request of financial advisors, MF Ops employees could reopen MSDW’s mutual fund trading system after 4:00 p.m. ET and enter, cancel, or amend orders, or allow the financial advisors to enter, cancel, or amend orders. These orders were priced at the same day’s NAV. MSDW did not have controls in place regarding the time of receipt of these new orders from customers or the price these orders would receive.

35. The FAs frequently contacted MF Ops after 4:00 p.m. EST to request entry of new orders or the cancellation or alteration of orders entered earlier in the day for their market-timing customers.

36. On September 15, 2003, MSDW changed its procedures to require that any requests for trades to be entered, cancelled, or altered after 4:00 p.m. ET be made by a branch manager by email. In December 2003, MSDW changed its procedures again to

prevent entry, cancellation, or alteration of trades after 4:00 p.m. ET.

37. The late-processed trades were not the product of any formal or informal agreements between MSDW and its customers. The Commission staff found no evidence of any scheme to exploit MSDW's order entry process or circumvent its controls. MSDW personnel did not receive any additional compensation in exchange for processing the substitute orders.

38. By its conduct described above, MSDW willfully violated Investment Company Act Rule 22c-1(a).

**MSDW Violated Exchange Act Section 17(a)(1) and Rule 17a-3 thereunder by Failing to Make and Keep Required Books and Records**

39. Section 17(a)(1) of the Exchange Act requires every registered broker or dealer to make and keep such records as the Commission, by rule, prescribes as necessary or appropriate in the public interest or for the protection of investors. Rule 17a-3(a)(6) thereunder requires a registered broker or dealer to make and keep current a memorandum of each brokerage order and of any other instruction, given or received for the purchase or sale of securities.

40. From 2000 to 2003, MSDW neither made nor kept a record of customer orders financial advisors communicated to MF Ops to place, cancel, or adjust trades.

41. Furthermore, two of MSDW's market-timing customers purchased variable annuity contracts through FA 1, FA 2, and FA 3. Each placed the hedge fund customers' market-timing trades in the variable annuity sub-accounts. Their branch managers, as well as MSDW's insurance division, knew these trades occurred. However, MSDW did not maintain records of orders received regarding the trading in the sub-accounts.

42. By its conduct described above, MSDW willfully violated Section 17(a)(1) of the Exchange Act and Rule 17a-3 thereunder.

**Respondent's Remedial Efforts**

43. In determining to accept the Offer, the Commission considered remedial acts undertaken by Respondent.

**Undertakings**

44. In determining to accept the Offer, the Commission has further considered the following undertakings by Respondent:

- a. Ongoing Cooperation: Respondent shall cooperate fully with the

Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the Order. In connection with such cooperation, MS&Co. agrees:

1. To produce, without service of a notice or subpoena, any and all nonprivileged documents and other information requested by the Commission's staff;
  2. To use its best efforts to cause its employees to be interviewed by the Commission's staff at such time as the staff reasonably may direct;
  3. To use its best efforts to cause its employees to appear and testify without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and
  4. That in connection with any testimony of MS&Co. employees to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, MS&Co.:
    - i. Agrees that any such notice or subpoena for MS&Co.'s employee's appearance and testimony may be served by regular mail on: Cathy Joyce, Esq., Winston & Strawn LLP, 35 West Wacker Drive, Chicago, Illinois 60601-9703
    - ii. Agrees that any such notice or subpoena for MS&Co.'s employee's appearance and testimony in any action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure.
- b. Distribution of Disgorgement and Civil Money Penalty: Respondent shall retain, within 60 days of the entry of this Order, the services of an independent distribution consultant ("Independent Distribution Consultant") acceptable to the staff of the Commission.
1. Respondent shall be responsible for all costs and expenses associated with the distribution of the disgorgement and penalty ordered in Section IV.C. of this Order, including, but not limited to (i) the compensation of a tax administrator for the preparation of tax returns and/or for seeking any IRS rulings and (ii) the payment of any distribution or consulting services as may be reasonably required by the Independent Distribution Consultant. The payment of taxes, if any, by the Qualified Settlement Fund shall be paid from any amounts of disgorgement or penalty paid by the Respondent pursuant to this Order and any investment returns or interest earned thereon.
  2. Respondent shall cooperate fully with the Independent Distribution Consultant to provide all information requested for its review, including providing access to its files, books, records, and personnel.

3. Respondent shall require the Independent Distribution Consultant to develop a proposed Distribution Plan for the distribution of the disgorgement and penalty ordered in Section IV.B. of this Order, and any interest or earnings thereon, according to a methodology developed in consultation with and acceptable to the staff of the Commission.
4. Respondent shall require the Independent Distribution Consultant to submit to Respondent and the staff of the Commission the proposed Distribution Plan no more than 180 days after the entry of this Order.
5. The proposed Distribution Plan developed by the Independent Distribution Consultant shall be binding unless, within 210 days after the date of entry of this Order, Respondent or the staff of the Commission advises, in writing, the Independent Distribution Consultant of any determination or calculation from the Distribution Plan that it considers to be inappropriate and states in writing the reasons for considering such determination or calculation inappropriate.
6. With respect to any calculation with which Respondent or the staff of the Commission do not agree, such parties shall attempt in good faith to reach an agreement within 240 days of the entry of this Order. In the event that Respondent and the staff of the Commission are unable to agree on an alternative determination or calculation, the determinations of the Independent Distribution Consultant shall be included in the proposed Distribution Plan.
7. Respondent shall require the Independent Distribution Consultant to submit the proposed Distribution Plan for the administration and distribution of disgorgement and penalty funds pursuant to the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1100, et seq., (Rule 1100 through Rule 1106) within 285 days of the date of entry of this Order. Following a Commission order approving a final plan of distribution, as provided in Rule 1104 [17 C.F.R. § 201.1104] of the SEC's Rules on Fair Fund and Disgorgement Plans, Respondent shall require the Independent Distribution Consultant to take all necessary and appropriate steps to administer the final plan for distribution of disgorgement funds in accordance with the terms of the approved Distribution Plan.
8. For the period of the engagement and for a period of two years from completion of the engagement, Respondent shall require the Independent Distribution Consultant not to enter into any employment, consultant, attorney-client, auditing, or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Respondent shall require that any firm with which the Independent Distribution Consultant is affiliated in performance of his or her duties under this Order, or of which he/she is a member, and any person

engaged to assist the Independent Distribution Consultant in the performance of his/her duties under this Order, will not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of Respondent's present or former affiliates, directors, officers, employees, or agents acting in the capacity as such for the period of the engagement and for a period of two years after the engagement.

9. For good cause shown, the staff of the Commission may alter any of the procedural deadlines set forth above.

#### IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

- A. Respondent shall be, and hereby is, censured;
- B. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(1) of the Exchange Act and Rule 17a-3 thereunder, and Rule 22c-1(a) under the Investment Company Act;
- C. IT IS FURTHER ORDERED that Respondent shall, within 10 business days of the entry of this Order, pay disgorgement of \$4,400,000.00, prejudgment interest of \$720,000.00, and a civil money penalty in the amount of \$11,880,000.00, for a total of \$17 million, to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or 31 U.S.C. § 3717. Such payment shall be: (A) made by company check, wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies MS&Co. as Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Christopher R. Conte, Esq., Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549;
- D. IT IS FURTHER ORDERED that, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement, interest and penalties referenced in paragraph 'C' above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all

tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that it shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that it is entitled to, nor shall either further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a Related Investor Action means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding; and

E. Respondent shall comply with the undertakings enumerated in Paragraph 44 'b' above.

By the Commission.

Nancy M. Morris  
Secretary