

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 60342 / July 20, 2009**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 2904 / July 20, 2009**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-13558**

**In the Matter of**

**Morgan Stanley & Co.**  
**Incorporated,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-  
AND-DESIST PROCEEDINGS,  
MAKING FINDINGS, AND  
IMPOSING REMEDIAL SANCTIONS,  
A CENSURE, AND A CEASE-AND-  
DESIST ORDER PURSUANT TO  
SECTION 15(b) OF THE SECURITIES  
EXCHANGE ACT OF 1934 AND  
SECTIONS 203(e) AND 203(k) OF THE  
INVESTMENT ADVISERS ACT OF  
1940**

**I.**

The Securities and Exchange Commission (“Commission”) deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934 (“Exchange Act”) and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Morgan Stanley & Co. Incorporated (“Morgan Stanley” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Morgan Stanley has submitted an Offer of Settlement (“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 Morgan Stanley and the subject matter of these proceedings, which are admitted, Morgan Stanley consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions, a Censure, and a Cease-and-Desist Order Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and

Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Order”), as set forth below.

### III.

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

#### A. SUMMARY

From 2000 through at least April 2006, Morgan Stanley (f/k/a Morgan Stanley DW Inc.) breached its fiduciary duty to certain of the firm’s advisory clients and prospective advisory clients of its Nashville, Tennessee branch office (“Nashville advisory clients”) by making material misstatements.

During the relevant period, Morgan Stanley’s disclosure materials described the advisory services it provided which included assisting clients in identifying money managers to manage clients’ assets. Morgan Stanley disclosed the detailed due diligence process it followed to select and approve money managers for participation in the firm’s managed account program. According to its disclosure materials, Morgan Stanley financial advisers selected money managers from this approved list of managers to recommend to clients based on the client’s investment profile and objectives.

Contrary to its disclosures, Morgan Stanley recommended to Nashville advisory clients certain money managers who were not approved for participation in Morgan Stanley’s advisory programs and had not been subject to the firm’s due diligence review. Further, the fact that Morgan Stanley and the former Morgan Stanley Financial Adviser in its Nashville office who serviced these clients (“Nashville FA”) received or had the possibility of receiving substantial brokerage commissions and/or fees from those money managers created an incentive for them to recommend these non-approved money managers. These facts represented an actual or potential conflict of interest which was not disclosed to the Nashville advisory clients.

As a result, Morgan Stanley violated Section 206(2) of the Investment Advisers Act of 1940 (“Advisers Act”). In addition, Morgan Stanley failed reasonably to supervise the Nashville FA with a view to preventing these violations within the meaning of Section 203(e)(6) of the Advisers Act. Further, Morgan Stanley violated Section 204 of the Advisers Act and Rules 204-2(a)(7) and 204-2(a)(10) thereunder by failing to maintain (1) all account paperwork reflecting Morgan Stanley’s written agreements with its advisory clients; and (2) all written communications relating to recommendations of money managers.

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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.

## **B. RESPONDENT**

**Morgan Stanley & Co. Incorporated (“Morgan Stanley”)**, located in New York, New York is dually registered with the Commission as an investment adviser pursuant to Section 203(a) of the Advisers Act and as a broker-dealer pursuant to Section 15 of the Securities Exchange Act of 1934. Respondent Morgan Stanley is a wholly-owned subsidiary of Morgan Stanley, a Delaware corporation, located in New York, New York whose shares are traded on the New York Stock Exchange. Prior to 2007, Respondent Morgan Stanley was registered and operated under the name Morgan Stanley DW Inc.

## **C. FACTS**

### **Morgan Stanley’s Investment Advisory Services**

From 2000 through at least April 2006, through a subdivision of its Consulting Services Group called Investment Consulting Services (“ICS”), which is headquartered in New York, New York, Morgan Stanley provided investment advisory services. In providing investment advisory services, Morgan Stanley assisted clients in creating an investment profile, defining investment objectives and selecting money managers on whom the firm had conducted due diligence to manage clients’ assets. Among the types of advisory accounts offered by Morgan Stanley were the so-called Vision I and Vision III accounts. Morgan Stanley described the Vision I and Vision III programs and its due diligence process in a disclosure statement and in its Form ADV, Part II, filed with the Commission.

In the Vision I program, Morgan Stanley assisted clients in developing investment objectives and in selecting money managers from a list of money managers, approved to participate in the Vision I program, to manage clients’ assets. To become an approved manager for the Vision I program, Morgan Stanley performed due diligence through its due diligence group within ICS, as described in its disclosure statements. The due diligence group was comprised of approximately 25 individuals. The due diligence review included, among other things, on-site interviews of the manager’s personnel and an evaluation of each manager’s performance as compared to standard relative indices, as well as to the performance of managers within similar investment styles. Managers were further evaluated by Morgan Stanley on their investment strategy and on the strength and reputation of their organizations, such as the qualifications of management, their administrative capabilities, and their compliance with regulatory requirements. Final selection of managers was subject to review and approval by a Morgan Stanley senior management due diligence committee.

Morgan Stanley provided custody, execution, and performance reporting for clients and also performed ongoing due diligence and monitoring of all managers selected to participate in the Vision I program. The ongoing monitoring of approved managers, as described in disclosure materials, included periodic reevaluation of the manager by Morgan Stanley, including reviews of performance, assets under management, personnel

changes and account turnover to determine whether the manager should remain eligible for participation in the Vision I program. Morgan Stanley described the Vision I program as follows:

Each Vision account is individually managed by one or more investment managers selected by the client from a group of investment managers specifically chosen by the ICS Department to participate in the Vision program.

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After receipt of appropriate information from and about the client, Morgan Stanley identifies several investment managers deemed suitable for the client from among those participating in the Vision program.

The Vision III program was designed to accommodate advisory clients who came to Morgan Stanley from another advisory firm and sought services under the firm's Vision I program, but who had a pre-existing relationship with a money manager who was not approved for the Vision I program and consequently had not been subject to Morgan Stanley's due diligence review. Under Vision III, clients retained their relationship with the unapproved money manager and could also select additional money managers from Morgan Stanley's approved list of money managers. In the Vision III program, Morgan Stanley provided some of the same services as in the Vision I program (custody, execution, performance reporting); however, Morgan Stanley provided no due diligence on or ongoing monitoring of the non-approved money managers with which the client had a pre-existing relationship. Morgan Stanley also provided, as explained in its disclosure statements, ongoing monitoring of the money managers selected by the client who were approved to participate in the Vision I program. Morgan Stanley described the Vision III program as follows:

Certain clients may wish to receive some of Registrant's services under the Vision program but utilize an investment manager that does not participate in the Vision program. For such clients, Registrant provides an alternate version of the Vision program, Morgan Stanley Vision III. Except for the investment manager review and monitoring services described above, Vision III is the same in all material respects to the Vision program. Investment managers selected by clients in Vision III have not been approved by Morgan Stanley to participate in Vision, and are not monitored and evaluated by Morgan Stanley like managers in Vision.

## Morgan Stanley's Section 206 Violations

During the relevant time period, in breach of its fiduciary duty, Morgan Stanley materially misrepresented to certain clients of the Nashville, Tennessee branch office the process used to identify managers. As reflected above, Morgan Stanley's disclosure statement, in addition to its client services agreement, stated that Morgan Stanley would identify for clients of the Vision I program suitable money managers on whom the firm conducted due diligence and ongoing monitoring and who were specifically selected to participate in the Vision I program. However, contrary to these representations, the Nashville FA on several occasions recommended to the firm's Vision I advisory clients three money managers on whom Morgan Stanley had not conducted due diligence and who were not approved to participate in the Vision I program. Morgan Stanley did not disclose to these clients that the money managers recommended to them by the Nashville FA were not approved for participation in the Vision I program.

The Nashville FA had a financial incentive to recommend these three unapproved managers because of relationships he developed with the managers from which both he and Morgan Stanley benefited. First, Morgan Stanley, and consequently the Nashville FA, received brokerage commissions from the three unapproved managers for trading on behalf of the managers' institutional clients who were not clients of Morgan Stanley and whose assets were custodied outside of Morgan Stanley. During the relevant period, these three money managers generated at least \$3.3 million in brokerage commissions to Morgan Stanley. The Nashville FA received a portion of those commissions. Second, two of the unapproved managers caused certain of their clients to open advisory accounts with the Nashville FA, in some instances moving assets from another custodian. Morgan Stanley was compensated from these advisory accounts through either an asset fee or commissions. During the relevant period, the two unapproved managers generated at least \$200,000 in advisory fees for the benefit of Morgan Stanley. The Nashville FA received a portion of these fees. When the Nashville FA recommended the three money managers to the firm's advisory clients, the clients were not informed that Morgan Stanley and the Nashville FA had other relationships with the recommended money managers which gave Morgan Stanley an incentive to make those recommendations. These incentives created an actual or potential conflict of interest which should have been sufficiently disclosed so that the client could evaluate whether the recommendations were disinterested. Investment advisers, such as Morgan Stanley, owe fiduciary duties to their clients and, therefore, must, among other things, disclose all actual or potential conflicts of interest.<sup>2</sup>

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<sup>2</sup> SEC v. Capital Gains Research Bureau Inc., 375 U.S. 180, 191, 196-97 (1963) ("The Investment Advisers Act of 1940 thus reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship . . . . An investor seeking the advice of a registered investment adviser must, if the legislative purpose is to be served, be permitted to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether the adviser is serving two masters or only one, especially if one happens to be economic self-interest."); In re O'Brien Partners, Inc., Advisers Act Release No. 1772 (Oct. 27, 1998) (" . . . since even potential conflicts of interest are material and must be disclosed, [the investment adviser] was required to disclose its receipt of third-party payments, even if it had concluded that the payments did not influence the manner in which it advised its clients."); In the Matter of Feeley & Willcox Asset Management Corp., Advisers Act Release No. 2143 (July 10, 2003) ("It is the client, not the adviser, who is entitled to make the determination whether to waive the adviser's conflict.

Based on the above, Morgan Stanley knew or should have known that it made misrepresentations to its advisory clients and failed to disclose material conflicts of interest. As a result, Morgan Stanley willfully<sup>3</sup> violated Section 206(2) of the Advisers Act, which provides that “[i]t shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly . . . to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.”<sup>4</sup>

### **Morgan Stanley Failed to Supervise the Nashville FA**

During the relevant time period, Morgan Stanley failed reasonably to supervise the Nashville FA with a view to preventing violations of the federal securities laws. The Nashville FA was recruited in March 2000 from another firm where he had been a top producer and financial adviser for ten years. The Nashville FA brought with him to Morgan Stanley several institutional money manager brokerage customers as well as several individual advisory clients. Morgan Stanley was well aware of the dual nature of his business; that he conducted both brokerage and advisory business. Morgan Stanley was also aware when the Nashville FA was hired that two of the Nashville FA’s former advisory clients had filed complaints against him alleging, among other things, that he had breached his fiduciary duty to them and failed to disclose certain conflicts of interest. Morgan Stanley also knew of a subsequent similar complaint made by a client of the Nashville FA during the course of his Morgan Stanley employment.

Notwithstanding these facts, Morgan Stanley’s supervision of the Nashville FA failed to monitor for such potential problems. Specifically, Morgan Stanley failed to ensure that the dual nature of the Nashville FA’s business, which had the potential for conflicts of interest, was appropriately supervised. To begin, there was confusion as to who had responsibility for overseeing certain aspects of the Nashville FA’s advisory business. For instance, the Nashville FA’s branch manager thought that the ICS department was responsible for supervising compliance with Morgan Stanley’s policies and procedures with regard to money manager recommendations, while instead, the ICS department thought that responsibility was the branch manager’s.

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Of course, if the adviser does not disclose the conflict, the client has no opportunity to evaluate, much less waive, the conflict.”).

<sup>3</sup> A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

<sup>4</sup> Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. SEC v. Capital Gains Research Bureau Inc., 375 U.S. 180, 195 (1963).

The confusion and lack of clarity in supervisory responsibilities resulted in an inadequate review of paperwork relating to the recommendation of money managers which allowed the Nashville FA to make material misrepresentations to certain Nashville advisory clients. The Nashville FA on several occasions submitted advisory account paperwork to his branch manager and ICS department reflecting that he was placing Vision I clients with non-vetted, unapproved managers, contrary to the firm's representations and disclosures regarding Vision I. In addition, the Nashville FA on several occasions submitted account paperwork that contained mixed Vision I and Vision III paperwork, two distinct types of accounts with contradictory client disclosures. These accounts were routinely approved without question by both the branch manager and the ICS department because each thought the other would ensure compliance.

Notably, during most of his six years at Morgan Stanley, the Nashville FA was supervised by a branch manager who previously had been sanctioned for supervisory failures. In addition, there were several instances when the Nashville FA refused to comply with Morgan Stanley's policies and procedures. For example, a year into his employment, the Nashville FA refused to sign an acknowledgment that he would abide by Morgan Stanley's code of conduct. Further, later in his tenure, the Nashville FA refused to be placed under heightened supervision by Morgan Stanley and the firm did not pursue the matter.

Based on the foregoing, Morgan Stanley failed reasonably to supervise the Nashville FA who aided and abetted Morgan Stanley's violations of Section 206(2) of the Advisers Act, with a view to preventing violations of the Advisers Act.

### **Morgan Stanley Did Not Maintain Adequate Records**

During the relevant time period, as mentioned above, based on a client's responses to an Investor Questionnaire, Morgan Stanley generated an Investor Profile which recited the client's responses and identified suitable managers. Morgan Stanley failed to maintain all Investor Profiles or any other record of all written communications relating to recommendations of money managers. As a result, Morgan Stanley willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(7) thereunder which requires that investment advisers registered with the Commission maintain and preserve certain books and records. Rule 204-2(a)(7) requires that registered investment advisers keep "all written communications sent by such investment advisers relating to (i) any recommendation made or proposed to be made and any advice proposed to be given or given." In addition, Morgan Stanley failed to maintain all account paperwork including Morgan Stanley's written agreements with its advisory clients. As such Morgan Stanley willfully violated Rule 204-2(a)(10) which requires that registered investment advisers keep "all written agreements (or copies thereof) entered into by the investment adviser with any client . . . ."

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Beginning in 2006, Morgan Stanley took remedial steps to address the issues discussed herein.

#### IV.

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

Accordingly, pursuant to Section 15(b) of the Exchange Act and Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

- A. Morgan Stanley is censured;
- B. Morgan Stanley cease and desist from committing or causing any violations and any future violations of Sections 204 and 206(2) of the Advisers Act, and Rules 204-2(a)(7) and 204-2(a)(10) thereunder; and
- C. Morgan Stanley shall, within 90 days of the entry of this Order, pay a civil money penalty in the amount of \$500,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by 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, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Morgan Stanley as a 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 Laura B. Josephs, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

By the Commission.

Elizabeth M. Murphy  
Secretary