

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3315 / November 16, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29862 / November 16, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14628

In the Matter of

**MORGAN STANLEY
INVESTMENT
MANAGEMENT INC.,**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 203(e) AND
203(k) OF THE INVESTMENT ADVISERS
ACT OF 1940, AND SECTIONS 9(b) AND 9(f)
OF THE INVESTMENT COMPANY ACT OF
1940, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

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 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against Morgan Stanley Investment Management Inc. (“MSIM” or “Respondent”).

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 Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of

1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that:

Summary

These proceedings arise out of certain investment advisory fees improperly charged to a registered fund from 1996 to 2007. MSIM, the primary investment adviser to The Malaysia Fund, Inc. (“Fund”), represented to investors and the Fund’s board of directors (“Board”) that the Fund’s Malaysian sub-adviser was providing certain services that the sub-adviser in fact was not providing. The Board approved the sub-adviser’s fees each year based on MSIM’s representations. As a result, the Fund paid approximately \$1.8 million to the sub-adviser between 1996 and the end of 2007 (the “relevant time period”) for advisory services it did not receive. In early 2008, after Commission examination staff inquired into the Fund’s relationship with the sub-adviser, the sub-adviser’s services were terminated.

Throughout the relevant time period, the Fund had a Research and Advisory Agreement with AMMB Consultant Sendirian Berhad (“AMMB”) and MSIM, under which AMMB undertook to provide advice, research, and assistance to MSIM for the benefit of the Fund. Each year during the relevant period, in connection with the Fund’s annual investment advisory contract approval process, AMMB submitted to MSIM a report for the Board that falsely claimed it was providing specific research, intelligence, and advice to MSIM. MSIM included this report as part of the materials it submitted to the Fund’s Board for the renewal of its and AMMB’s advisory agreements. MSIM also submitted two compliance reports to the Fund during the relevant period indicating that AMMB was providing advisory services. In reality, AMMB’s advisory services were limited to preparing two minor monthly reports for MSIM, which MSIM’s portfolio management team neither requested nor used in its management of the Fund. At the same time, MSIM, which was responsible for preparing the Fund’s annual and semi-annual reports to shareholders, repeatedly issued reports representing that AMMB was providing advisory services to MSIM, when in fact it was not.

Section 15(c) of the Investment Company Act requires an investment adviser of a registered investment company to furnish such information as may reasonably be necessary for such company’s directors to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of the company. As described above, MSIM did not provide the Fund’s Board with information reasonably necessary for the Board to evaluate the nature, quality, and cost of AMMB’s services. MSIM also represented to the Fund’s Board and investors that AMMB was providing advisory services to MSIM for the benefit of the Fund when it was not. Finally, MSIM did not adopt and implement procedures governing its oversight of

¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

AMMB and its provision of information regarding AMMB's services to the Board in connection with the investment advisory contract renewal process.

Respondent

1. MSIM, a Delaware corporation, is a registered investment adviser and wholly owned subsidiary of Morgan Stanley. MSIM has been the investment adviser to the Fund since its inception in 1987. MSIM has been registered with the Commission since January 1981.

Other Relevant Entities

2. The Fund is a Maryland corporation, formed in March 1987, as a closed-end investment company launched and managed by MSIM. The fund invests in equity securities of Malaysian companies.

3. AMMB, located in Kuala Lumpur, Malaysia, was an investment adviser registered with the Commission from May 8, 1987 until February 12, 2008, when it withdrew its registration. AMMB is a wholly owned subsidiary of AM Bank Group, one of the largest banking groups in Malaysia.

Background

4. The Fund is a closed-end investment company that is part of the Morgan Stanley funds complex, which is currently comprised of approximately 100 institutional and retail funds or portfolios and is overseen by a single board of directors, all but one of whom is not "interested" within the meaning of the Investment Company Act. The Fund's objective is long-term capital appreciation through investment in equity securities of Malaysian companies. As of June 30, 2011, the Fund reported net assets of \$93.8 million.

5. MSIM serves as the primary investment adviser for the Fund. MSIM entered into a written advisory agreement with the Fund effective May 1, 1987, to provide the Fund with investment management services, including investment trading and maintenance of the Fund's books and records. The Fund pays MSIM a fee at an annual rate of 0.90% of the Fund's first \$50 million of average weekly net assets; 0.70% of the Fund's next \$50 million of average weekly net assets; and 0.50% of the Fund's average weekly net assets in excess of \$100 million. MSIM is also the Fund's administrator and responsible for the overall management and administration of the Fund, including the preparation of the Fund's annual and semi-annual reports, preparation of materials for board of directors meetings, and compliance monitoring. For its administrative services, the Fund pays MSIM an annual fee, in monthly installments, of a percentage of the average weekly net assets of the Fund, plus \$24,000 per annum.

6. AMMB served as a sub-adviser to the Fund from inception until it was terminated effective December 31, 2007, pursuant to a Research and Advisory Agreement with the Fund. MSIM was also a party to this agreement, which is separate from MSIM's advisory agreement with the Fund. This Research and Advisory Agreement, which is dated May 1, 1987 (and was amended June 1, 1997), specified that AMMB would register with the Commission as an

investment adviser under the Advisers Act and furnish MSIM “such investment advice, research and assistance, as [MSIM] shall from time to time reasonably request.” AMMB did not exercise investment discretion or authority over any of the assets in the Fund. The agreement also provided for annual review and approval of its terms by the Board. MSIM undertook in the agreement to “work closely” with AMMB and assist it in “developing its research techniques, procedures and analysis.” MSIM also agreed to work with AMMB “in order to make [the] relationship as productive as possible for the benefit of the Fund and to further the development of [AMMB’s] ability to provide the services contemplated.” To that end, MSIM agreed to furnish AMMB with informal memoranda reflecting MSIM’s understanding of its “working procedures” with AMMB. MSIM took responsibility for monitoring AMMB’s performance of services.

7. The Research and Advisory Agreement provided that the Fund would pay AMMB a fee at an annual rate of 0.25% of the Fund’s first \$50 million of average weekly net assets; 0.15% of the next \$50 million of average weekly net assets; and 0.10% of the average weekly net assets in excess of \$100 million. During the relevant time period, the Fund paid AMMB advisory fees totaling \$1,845,000. As the fund administrator, MSIM facilitated the Fund’s payment of AMMB’s advisory fees.

Investment Advisory Contract Renewal Process

8. Under Section 15(a) of the Investment Company Act, it is unlawful for any person to serve or act as investment adviser to a registered investment company except pursuant to a written contract that satisfies certain criteria and that has been approved by a majority of the outstanding voting securities. The original contract can continue in effect for more than two years from its date of execution only so long as such continuance is specifically approved at least annually by the Board or by a vote of a majority of the outstanding voting securities. Section 15(c) of the Investment Company Act requires that the terms of any contract or agreement, whereby a person undertakes regularly to serve or act as investment adviser of a registered investment company, and any renewal thereof, be approved by a vote of the majority of a fund’s disinterested directors or trustees at a meeting called for the purpose of voting on such approval. Section 15(c) also makes it the duty of an investment adviser of a registered investment company to furnish such information as may reasonably be necessary for fund directors to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company. The process by which a fund board evaluates and approves the renewal of an investment advisory contract is commonly referred to as the “15(c) process.”

9. Each year, the Board evaluated the terms of MSIM’s advisory agreements and all sub-advisory agreements with each fund in the Morgan Stanley fund complex. During the entire relevant time period, the Fund was one of two Morgan Stanley funds that had agreements with unaffiliated sub-advisers, such as AMMB.

10. The Board’s investment advisory contract approval process worked in substantially the same way throughout the relevant time period. During the 15(c) process each year, MSIM provided the Board with detailed information regarding each adviser and sub-adviser. While the type of information MSIM provided to the Board varied over time, typical

information provided included copies of all advisory agreements and a description of any proposed changes in services or fees, a copy of each adviser's most current Form ADV Parts 1 and II, and current financial statements for each adviser.

11. The Board reviewed the information MSIM provided in order to evaluate the various advisory agreements. At a meeting held during the spring of each year during the relevant period, the Board voted to renew MSIM's and AMMB's advisory contracts with the Fund.

12. Every year since at least 1994 as part of the Fund's advisory contract renewal process, AMMB prepared a report to the Board of Directors on the "Continuance of [AMMB's] Research and Advisory Agreement" ("Report"). The stated purpose of the Report was to provide the Fund's Board with information AMMB believed "may reasonably be necessary for the Board to evaluate terms of the sub-adviser agreement." AMMB represented to the Board in each of the Reports that it provides the following services to MSIM: (a) research on Malaysian companies to identify and recommend stocks for investment by MSIM; (b) statistical reports to assist MSIM in making investment decisions; (c) market intelligence on local corporate developments; and (d) advice on changes in economic and political conditions in Malaysia. The Report also identified key AMMB personnel and included AMMB's unaudited financial statements.

13. AMMB provided the Reports directly to MSIM, which included them in the materials it submitted to the Board as part of the 15(c) process along with a copy of the Research and Advisory Agreement. In the years from 2005 to 2007, MSIM submitted these materials to the Board in connection with the 15(c) process and represented that the advisory services were as described in the relevant agreements and disclosure documents. MSIM also included, in the years 2006 and 2007, an annual compliance program review prepared pursuant to Rule 38a-1 of the Investment Company Act. These annual compliance reports state that AMMB "provides research and investment advisory services to MSIM Inc."

AMMB's Actual Services and MSIM's Oversight of Those Services

14. Contrary to AMMB's 15(c) Reports, AMMB did not provide any of the services it and MSIM represented to the Board it provided during the relevant period. Instead, AMMB provided two monthly reports that MSIM neither requested nor used in its management of the Fund. The first was a two-page list of the market capitalization of the Kuala Lumpur Composite Index. The second was a two-page comparison of the monthly performance of the Fund against other Malaysian equity trusts. Both reports were based on readily available public information. MSIM had no contact with AMMB about the two reports.

15. For twelve years, the Board relied on MSIM's representations and submissions of information regarding AMMB's services when it unanimously approved the continuation of AMMB's advisory contracts.

16. Even though MSIM took responsibility for monitoring AMMB's services, its oversight and involvement with AMMB during the relevant time period were wholly inadequate.

MSIM had no written procedures specifically governing its oversight of sub-advisers, and it did not have a procedure in place for reviewing work done by AMMB. MSIM did not conduct due diligence visits of AMMB and performed no other routine supervision of AMMB. Contrary to the advisory agreement, MSIM did not work with AMMB in developing research or engage in any regular communication or exchange any informal memoranda regarding their working relationship during the relevant time period. Controls such as this were particularly critical to MSIM due to its global advisory business which extended to numerous offices and service providers around the world.

Statements to Investors

17. Throughout the relevant time period, MSIM was responsible for preparing and filing the Fund's annual and semi-annual reports to shareholders. The Fund's notes to the financial statements in its annual and semi-annual reports stated that for an advisory fee, AMMB provided "investment advice, research and assistance on behalf of the Fund to Morgan Stanley Investment Management, Inc. under terms of a contract." In fact, AMMB was not providing MSIM with any advisory services. For twelve years, MSIM prepared and filed annual and semi-annual reports representing that AMMB was providing advisory services to MSIM for the benefit of the Fund, which AMMB was not.

Termination of the Advisory Contract with AMMB

18. In late 2007, in response to an examination by the Commission staff into the Fund's relationship with AMMB, MSIM initiated its own investigation into AMMB's advisory services. MSIM confirmed the staff's conclusion that since at least 2000, AMMB had been providing MSIM with two reports, which the applicable portfolio managers never used in their management of the Fund. As a result, in February 2008, the Board voted to terminate AMMB's agreement. MSIM acknowledged to the Board that the reports provided "fell short of what was described in the 15(c) reports to the Board" and noted that "certain internal controls needed improvement."

Violations of Law

19. Section 15(c) of the Investment Company Act requires, among other things, that the terms of any contract or agreement, whereby a person undertakes regularly to serve or act as investment adviser of a registered investment company, and any renewal thereof, be approved by a vote of the majority of a fund's disinterested directors or trustees at a meeting called for the purpose of voting on such approval. Section 15(c) also makes it the duty of an investment adviser of a registered investment company to furnish such information as may reasonably be necessary for fund directors to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company.

20. MSIM willfully² violated Section 15(c) of the Investment Company Act by failing to provide the Fund's Board with information necessary for the Board to evaluate the nature,

² 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.

quality, and cost of AMMB's services. Each year during the relevant period, MSIM provided the Board with, among other things, AMMB's 15(c) Report, which falsely represented the advisory services AMMB was providing to MSIM purportedly for the benefit of the Fund. In the years from 2005 to 2007, MSIM submitted AMMB's report and Research and Advisory Agreement to the Board in connection with the 15(c) process and represented that services were as described in the relevant agreements and disclosure documents. The Board relied on this information in approving the renewal of AMMB's advisory contracts. MSIM's violations resulted in the Fund paying for advisory services it did not receive.

21. Section 206(2) of the Advisers Act prohibits an investment adviser from engaging "in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client" and imposes on investment advisers a fiduciary duty to act in "utmost good faith," to fully and fairly disclose all material facts, and to use reasonable care to avoid misleading clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191, 194 (1963). MSIM willfully violated Section 206(2) of the Advisers Act by representing and providing information to the Fund's Board that AMMB was providing advisory services to MSIM for the benefit of the Fund, which it was not.

22. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require registered investment advisers to adopt and implement written procedures reasonably designed to prevent violations of the Advisers Act. MSIM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 by failing to adopt and implement written policies and procedures tailored to the firm's advisory business that were reasonably designed to detect and prevent Advisers Act violations. MSIM failed to adopt and implement procedures governing its oversight of AMMB's services and its representations and provision of information to the Board regarding those services in connection with the investment advisory contract renewal process.

23. Section 34(b) of the Investment Company Act makes it unlawful for any person "to make any untrue statement of a material fact" in a document filed or transmitted pursuant to the Act. The same section makes it unlawful to omit from any such document any fact necessary in order to prevent the statements made therein from being materially misleading. *Brown v. Bullock*, 194 F. Supp. 207, 231 (S.D.N.Y. 1961). See also *SEC v. Advance Growth Capital Corp.*, 470 F.2d 40, 52 (7th Cir. 1972). MSIM willfully violated Section 34(b) of the Investment Company Act by preparing and distributing on behalf of the Fund materially false and misleading annual and semi-annual reports stating that AMMB provided "investment advice, research and assistance on behalf of the Fund to Morgan Stanley Investment Management, Inc. under terms of a contract." In fact, AMMB was not providing MSIM with any advisory services.

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)).

Undertakings

Respondent has agreed to the following undertakings:

24. MSIM shall, within 10 days of the entry of this Order, make a payment to the Fund in the amount of \$1,845,000 to reimburse the Fund for the amount of advisory fees the Fund paid to AMMB from 1996 until the end of 2007, less a credit of \$543,000 for the portion MSIM has already reimbursed to the Fund.

25. Within 45 days of the entry of this Order, MSIM shall implement and maintain policies and procedures specifically governing the Section 15(c) process and its oversight of advisers and sub-advisers, principal underwriters, administrators, and transfer agents (collectively “service providers”). Such policies and procedures shall include, but are not limited to, the following:

(i) MSIM’s policies and procedures shall require MSIM personnel with direct knowledge of any applicable adviser’s, sub-adviser’s, or principal underwriter’s agreements and services to review and verify any information and representations the adviser, sub-adviser, or principal underwriter provides or makes in the Section 15(c) contract renewal process;

(ii) MSIM’s policies and procedures shall require MSIM to obtain from each unaffiliated service provider, other than unaffiliated sub-advisers, an annual certification that the services were performed. In the case of unaffiliated sub-advisers not exercising investment discretion, MSIM’s policies and procedures shall require MSIM to obtain from such sub-adviser a quarterly certification that the services were performed. In addition, with respect to unaffiliated sub-advisers, MSIM personnel at the Executive Director level or above in MSIM’s Global Equity Group and Operations Group shall certify on a quarterly basis that the services were performed. Furthermore, prior to MSIM paying the unaffiliated sub-advisers from the assets of any registered investment company, MSIM’s Fund Administration Group shall review the last prior certifications received by it. It is the responsibility of MSIM’s Global Equity Group and Operations Group to identify and ensure the appropriate MSIM personnel provide the certifications with respect to the unaffiliated sub-advisers;

(iii) MSIM shall implement policies and procedures to ensure that it provides accurate descriptions of any service providers and their services to any registered investment company sponsored by it for which it acts as investment adviser. As such, MSIM shall ensure that personnel with sufficient knowledge of the service providers’ agreements and services review any descriptions of the services providers contained in a registration statement, application, report, account, record, or other document filed or transmitted pursuant to the Investment Company Act, and any financial statements and marketing materials.

26. MSIM shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertaking, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Chad Alan Earnst, Assistant Regional Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

In determining whether to accept the Offer, the Commission has considered these undertakings.

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent MSIM cease and desist from committing or causing any violations and any future violations of Sections 15(c) and 34(b) of the Investment Company Act, and Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

B. Respondent MSIM is censured.

C. Respondent MSIM shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$1,500,000 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 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies MSIM as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and wire transfer, money order or check shall be sent to Bruce Karpati, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY 10281-1022.

D. Respondent shall comply with the undertakings enumerated in paragraphs 25 and 26 above.

By the Commission.

Elizabeth M. Murphy
Secretary