

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

**Securities Exchange Act of 1934  
Release No. 54047 / June 27, 2006**

**Investment Advisers Act of 1940  
Release No. 2526 / June 27, 2006**

**Administrative Proceeding  
File No. 3-12342**

---

**In the Matter Of**

**MORGAN STANLEY & CO.  
INCORPORATED and  
MORGAN STANLEY DW INC.,**

**Respondents.**

---

**: ORDER INSTITUTING  
: PROCEEDINGS PURSUANT TO  
: SECTIONS 15(b)(4) AND 21C OF  
: THE SECURITIES EXCHANGE ACT  
: OF 1934, AND SECTIONS 203(e) AND  
: 203(k) OF THE INVESTMENT  
: ADVISERS ACT OF 1940, MAKING  
: FINDINGS, AND IMPOSING CEASE-  
: AND-DESIST ORDERS, PENALTIES,  
: AND OTHER RELIEF  
:  
:**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings pursuant to Sections 15(b)(4) and 21C 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”), be and hereby are instituted against Morgan Stanley & Co. Incorporated (“MS & Co.”) and Morgan Stanley DW Inc. (“MSDW”) (collectively, “Morgan Stanley” or “Respondents”).

**II.**

In anticipation of the institution of these proceedings, the Respondents have submitted an Offer of Settlement (“Offer”) to the Commission, 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, the Respondents, without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and over the subject matter of these proceedings, consent to the entry of this Order Instituting Proceedings Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934, and Sections 203(e) and 203(k) of the

Investment Advisers Act of 1940, Making Findings, and Imposing Cease-and-Desist Orders, Penalties, And Other Relief (“Order”).

### III.

On the basis of this Order and the Respondents’ Offer, the Commission finds that:

#### A. RESPONDENTS

1. **Morgan Stanley & Co. Incorporated** is a Delaware corporation with its principal place of business in New York, New York. MS & Co. is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, and is a member of self-regulatory organizations, including the NASD and New York Stock Exchange. MS & Co. is also a registered investment adviser pursuant to Section 203(c) of the Advisers Act. MS & Co. engages in a nationwide securities business.

2. **Morgan Stanley DW Inc.** is a Delaware corporation with its principal place of business in New York, New York. MSDW is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, and is a member of self-regulatory organizations, including the NASD and the New York Stock Exchange. MSDW is also a registered investment adviser pursuant to Section 203(c) of the Advisers Act. MSDW engages in a nationwide securities business.

#### B. SUMMARY

MS & Co. and MSDW, like all registered broker-dealers and investment advisers, are required by the securities laws to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of their business, to prevent the misuse of material nonpublic information by them and any person associated with them. Given the extensive financial businesses conducted by MS & Co. and MSDW, certain categories of employees are regularly in possession of material nonpublic information or in contact with employees who are in possession of such information pertaining to Morgan Stanley’s clients. Morgan Stanley has certain policies and procedures designed to prevent misuse of material nonpublic information. Among other things, Morgan Stanley maintains a “Watch List” of companies about whom Morgan Stanley is in possession of material nonpublic information. Morgan Stanley is required by its policies to conduct surveillance of trading by its employees, certain people related to its employees, and the firm for its own account, in the securities of Watch List companies to determine if those trades were made improperly with the benefit of material nonpublic information.

Despite the legal requirements to do so, Morgan Stanley, for years, failed to maintain and enforce adequate written policies and procedures to prevent the misuse of material nonpublic information by Morgan Stanley or persons associated with it. Due to a systemic breakdown in this critical compliance function, Morgan Stanley failed to conduct any surveillance of a massive number

of accounts and securities. Moreover, Morgan Stanley's written policies failed to provide adequate guidance to Morgan Stanley personnel charged with conducting surveillance, and there were inadequate controls in place with respect to certain aspects of Watch List maintenance.

Morgan Stanley's specific failures included:

- From at least 2000 to 2004, Morgan Stanley failed to conduct any Watch List surveillance of hundreds of thousands of employee and employee-related accounts to determine whether securities in those accounts had been purchased or sold on the basis of material nonpublic information.
- From at least 1999 to 2003, Morgan Stanley failed to conduct any daily Watch List surveillance of trading in *any* accounts with respect to some or all of the securities of approximately 3,000 issuers that had been placed on the firm's Watch List specifically so that trading in those securities would be monitored.
- From as early as 1997 until as late as 2005, Morgan Stanley failed to conduct any surveillance of trading in approximately 900 employee accounts held outside of Morgan Stanley and approximately 30,000 employee accounts held at Morgan Stanley that the firm failed to identify as held by employees.
- From at least 2001 until 2004, Morgan Stanley failed to conduct any of the surveillance required by its policies of certain types of securities traded in MSDW and MS & Co. accounts, including certain derivative securities, single stock futures, and equity options pertaining to issuers that Morgan Stanley had placed on its Watch List.
- From at least 2000 to October 2004, Morgan Stanley failed to conduct surveillance of certain Watch List securities traded in certain employee and employee-related accounts held at MSDW due to failures in the firm's systems for identifying and matching certain internal securities identifiers.
- From at least 1997 to 2006, Morgan Stanley's written policies pertaining to Watch List surveillance were inadequate because they failed to provide clear guidance regarding the manner in which surveillance was to be conducted.
- For years, Morgan Stanley failed to adequately maintain and implement its written policies and procedures with respect to maintaining the Watch List. In implementing its policies for placing companies on the Watch List, Morgan Stanley failed to put in place adequate controls to ensure that the steps involved in the process were completed consistently and correctly, so that all appropriate securities were placed on the Watch List.

All of the items set forth above were discovered following the commencement of an investigation by the Commission staff. As a result of these systemic failures, Morgan Stanley may

have failed to detect illegal insider trading by the firm, its employees, or people related to its employees.

### **C. BACKGROUND**

Morgan Stanley, the parent company,<sup>1</sup> is a global financial services firm that employs more than 53,000 people worldwide and does business through various subsidiaries, including MS & Co. and MSDW. As noted, MS & Co. and MSDW are both registered broker-dealers and registered investment advisers. As such, they are required by law to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of their business, to prevent the misuse of material nonpublic information by them and any person associated with them.

MS & Co. employed between approximately 11,000-12,000 people during the relevant period of time and conducted various securities businesses. MS & Co.'s employees are part of Morgan Stanley, the parent company's, "Institutional Securities Group." That group includes the investment banking business, which includes securities underwriting and distribution services and financial advisory services, including advice on mergers and acquisitions, restructurings and other transactions. In the course of conducting these businesses, various MS & Co. employees have regular occasion to come into possession of material nonpublic information or into contact with that information or other employees who have, or have access to, such information. The Institutional Securities Group also includes other securities businesses, including, among others, sales, trading, financing and market-making activities.

MSDW employed between approximately 20,000-29,000 people during the relevant period of time and also engaged in various securities businesses. MSDW employees are predominantly associated with the parent company's "Individual Investor Group." This business segment includes comprehensive brokerage, investment and financial services and operates in the United States through representatives located in approximately 525 retail locations. Although the vast majority of MSDW's employees in the retail brokerage operations do not routinely come into possession of material nonpublic information, certain MSDW employees are in physical proximity with MS & Co. and other Morgan Stanley employees who are more routinely in contact with such information. Although Morgan Stanley, the parent company, makes an effort to separate employees who have material nonpublic information from those that do not, in some office locations investment banking employees and Individual Investor Group employees may work in the same office building. In addition, these employees may share common areas such as cafeterias.

As required by the securities laws, MS & Co. and MSDW had certain policies and procedures, including surveillance processes, designed to prevent and detect the misuse of material nonpublic information. Those processes suffered, however, from systemic failures that resulted in Morgan Stanley omitting large numbers of accounts and securities from the surveillance process.

---

<sup>1</sup> "Morgan Stanley" unless specifically referred to as the "parent company" refers collectively to MS & Co. and MSDW.

## **1. Watch List Maintenance And Surveillance**

Morgan Stanley maintains a “Watch List” to assist in monitoring the use of certain confidential information within the firm and to help identify securities trades that may have been made while the trader was in possession of material nonpublic information. According to Morgan Stanley’s written policies, the “Watch List is one of the firm’s primary tools in safeguarding against the misuse of material nonpublic information.” An issuer is added to the Watch List when Morgan Stanley “is, or may reasonably be expected to be, in possession of material nonpublic information regarding that issuer.” The Watch List is exclusively maintained and monitored by the Control Group, a unit of the firm’s Compliance Department that is responsible for monitoring the dissemination and use of material nonpublic information within the firm. It is the Control Group’s responsibility to conduct surveillance of certain trading that occurs in Watch List securities. The Control Group is required by Morgan Stanley policies to monitor firm proprietary trading, employees trading in their own accounts, employee-related trading, and trading by certain employees who have been given discretion to make investment decisions and trade on behalf of their clients.<sup>2</sup> Under Morgan Stanley’s procedures, in the event that the Control Group identifies problematic trades, it is responsible for investigating the nature of the trades and referring the conduct to the legal department if illegal trading activity is suspected. Although the legal department, in theory, would cause a trade to be broken if Morgan Stanley determined the trade was made improperly while the trader was in possession of material nonpublic information, the Control Group is not aware of any instance of insider trading since the 1997 merger between Morgan Stanley and Dean Witter Reynolds.

## **2. Surveillance Failures**

From at least 1999 and continuing for years, the Control Group failed to conduct required surveillance of trading in Watch List securities with respect to certain categories of accounts at the company. In addition, the Control Group failed to conduct Watch List surveillance across all accounts for a certain number of securities.

### **a. Accounts Not Surveilled**

Morgan Stanley failed to conduct surveillance of trading in large segments of its employee and employee-related accounts over extended periods of time. Some of the failures arose from the Morgan Stanley and Dean Witter Reynolds merger in 1997. Following the merger, the MSDW broker-dealer utilized an alphanumeric coding system to identify employee and employee-related accounts held with that broker-dealer. Accounts coded with a “1” were employee accounts and those with a “2” were employee-related. “MOR” coded accounts were those associated with employees of the legacy Morgan Stanley company. “DWR” coded accounts were those associated with employees of the legacy Dean Witter company. Under Morgan Stanley’s policies, the Control Group was

---

<sup>2</sup> “Employee-related” trading refers to trading by family members of Morgan Stanley employees who hold accounts at Morgan Stanley, as required by Morgan Stanley policy. According to Morgan Stanley’s surveillance policies, securities trades made by employees in the firm’s Private Wealth Management division who exercise discretion on behalf of clients to make trading and investment decisions are also monitored against the Watch List.

required to conduct surveillance of all employee and employee-related accounts for trading in Watch List securities.

**i. “DWR 1, DWR 2” Failure – 251,000 accounts.** From at least mid-2000 until April 2004, in contravention of Morgan Stanley’s written policies, the firm failed to conduct any surveillance of approximately 251,000<sup>3</sup> employee and employee-related accounts (those coded DWR 1 and DWR 2) for trading in Watch List securities.<sup>4</sup> The Control Group had previously reviewed two separate surveillance reports that captured trading in these accounts. The failure occurred after the Control Group changed its practices and ceased reviewing one of the reports because the Control Group apparently believed that all of the necessary data was contained in the second report. The Control Group was incorrect, however, because the second report was designed to capture trading in only a subset of the necessary accounts.<sup>5</sup> Control Group personnel failed to detect this error and failed ever to notice that they were no longer capturing trading in hundreds of thousands of accounts.

**ii. Misabeled Accounts – 183,082 accounts.** From at least early 2001 until April 2004, Morgan Stanley also failed to conduct any surveillance of approximately 183,082 accounts that were not correctly coded.<sup>6</sup> Due to an apparent oversight in the account coding process, these accounts were coded “1” or “2” but lacked the alphabetic “MOR” or “DWR” designation or, in some instances, were coded with a different alphabetic designation. These accounts were all employee or employee-related accounts that should have been, but were not, subject to surveillance.

**iii. Employee Accounts Held Outside Morgan Stanley.** From as early as 1997 until May 2004, at least 900 accounts held outside of Morgan Stanley by employees of Morgan Stanley were not subject to any surveillance by the Control Group.<sup>7</sup> Despite the firm’s policy that the Control Group should receive duplicate confirms and/or account statements to enable review of trading in those outside accounts, certain compliance units within Morgan Stanley failed to forward on to the Control Group the information about trading in these outside accounts. As a result, until 2004, Morgan Stanley did not know that it was not conducting any Watch List surveillance of these accounts.<sup>8</sup>

---

<sup>3</sup> For a portion of these accounts, Morgan Stanley determined that there were no security transactions at all during the relevant period. Consequently, no trading in Watch List securities was overlooked in those accounts during the relevant period. Specifically, 73,274 of the DWR 1 and DWR 2 accounts were inactive during the relevant period.

<sup>4</sup> An additional 2,828 accounts coded MOR 1 or 2 were omitted from surveillance during this time frame; 665 of those accounts were inactive during the relevant period.

<sup>5</sup> This subset generally included the accounts of employees most commonly in possession of material nonpublic information.

<sup>6</sup> Of this total, 85,601 accounts were inactive during the relevant period.

<sup>7</sup> The approximately 900 accounts were identified by Morgan Stanley as of a particular point in time; the total historical number of accounts that were not subject to surveillance is not known.

<sup>8</sup> In addition, within the Investment Management Division, for eleven outside employee accounts, Morgan Stanley as a whole (as distinct from the Control Group alone) was not aware of the existence of these accounts until it completed an internal review of employees’ compliance with the firm’s policies regarding outside accounts. Information about trading in those accounts also was not forwarded to the Control Group for surveillance purposes. Morgan Stanley Investment Management employs an annual certification process in an effort to identify all such outside accounts and to ensure that they are subject to surveillance; the eleven accounts were identified as a result of the annual certification process.

**iv. Employee Accounts Not Identified As Such.** Since the Morgan Stanley-Dean Witter merger in 1997 until May 2005, employees of MSDW were able to open certain accounts that were designated as corporate trust or other types of accounts. Although the accounts were controlled by employees or those related to the employees, and therefore should have been subject to surveillance, they were not designated as employee or employee-related in the account-opening process and were not reviewed during this entire time period. As a result, there are at least 1,500 accounts that should have been monitored by Morgan Stanley because they were employee or employee-related accounts but were not designated as such. Following the discovery of this problem, Morgan Stanley identified an additional 29,367 non-business accounts held at MSDW that were in fact employee or employee-related accounts that were not properly coded as such and were not subject to surveillance. In addition, Morgan Stanley discovered during the third and fourth quarters of 2004 that at least 85 employee accounts held at the MS & Co. broker-dealer were not correctly labeled as such due to ministerial error. These accounts were also not subject to any surveillance.

**b. Certain Watch List Securities Not Surveilled**

Morgan Stanley also failed to conduct any daily Watch List surveillance of trading with respect to some or all of the securities of approximately 3,000 issuers that were placed on the Watch List from at least 1999 until 2003.

Beginning in 1999, Morgan Stanley used a Lotus Notes database system for Watch List maintenance. To place a company on the Watch List, the Control Group would identify the securities of the issuer and their associated CUSIPs and enter them into the Lotus Notes system. Separately, the Control Group analysts then entered those CUSIPs into a mainframe system which generates the Watch List surveillance reports that are reviewed by the Control Group. Failure to add the correct CUSIP in the mainframe system resulted in the exclusion of the security from the Watch List surveillance reports that were reviewed daily by the Control Group in connection with the Watch List surveillance process.

As a result of an SEC investigation pertaining to the surveillance conducted by the Control Group with respect to a particular Watch List company, Morgan Stanley discovered that the securities for that company had not been entered into the mainframe system, and therefore, that any employee, employee-related and Morgan Stanley proprietary trading in the securities of that company would not have appeared on the daily Watch List surveillance reports reviewed by the Control Group. Morgan Stanley determined, at that point, that this was not an isolated incident and was, in fact, a widespread, multi-year problem. Morgan Stanley determined ultimately that some or all of the securities of approximately 3,000 issuers – although placed on the Watch List precisely so that trading in those securities could be monitored by the Control Group – had not been subject to daily Watch List surveillance due to the failure of the Control Group to place the securities into the mainframe system. Morgan Stanley is in the process of conducting, retrospectively, the required surveillance of the trading in these Watch List securities.

**c. Classes Of Securities Not Surveilled**

In addition to the broad omissions with respect to classes of accounts and Watch List securities that were not subject to any surveillance, Morgan Stanley also had particular failures with respect to certain types of securities that should have been subject to review and surveillance, but were not. For example, employee, employee-related and firm proprietary trading in single stock futures of issuers whose other securities were on the Watch List were not captured as part of Watch List surveillance for several years. In addition, although Morgan Stanley was required by its written policies to review options trading as part of its Watch List Surveillance, Morgan Stanley failed to review equity options trading activity in all MSDW employee and employee-related accounts from approximately October 2000 until October 2004, which included all trades in equity options related to any Watch List issuer. Morgan Stanley also failed to conduct surveillance with respect to a number of listed and “over the counter” derivative securities that were related to securities of issuers on the Watch List. These derivative securities were not included in the Watch List surveillance reports for years.

In addition to the above omissions, Morgan Stanley’s Watch List surveillance reports were also incomplete due to problems in the logic utilized by the software to generate the surveillance reports. Specifically, the reports did not contain all of the correct securities related to the issuers on the Watch List because Morgan Stanley’s system for generating the reports failed to match correctly certain internal security identifiers of securities held in employee and employee-related accounts at MSDW against MS & Co.’s common database of security identifiers of issuers on the Watch List. As a result, employee or employee-related trades in the incorrectly matched securities were not subject to surveillance. Separately, due to certain coding problems, additional securities with certain alphabetic qualifiers were excluded from Watch List surveillance.

**D. DEFICIENCIES IN CONTROL GROUP POLICIES AND PROCEDURES**

Morgan Stanley’s written policies and procedures were inadequate to prevent the misuse of material nonpublic information and did not provide adequate guidance to the Control Group with respect to Watch List surveillance. In addition, there were failures in controls with respect to maintaining the Watch List itself.

**1. The Control Group’s Written Policies Failed To Provide Clear Guidance With Respect To Conducting Surveillance.**

Each day, a Control Group analyst responsible for Watch List surveillance reviewed trades listed on the Watch List surveillance reports to determine whether any trades were suspicious, and therefore warranted further investigation. This is a critical step in surveillance because if the analyst at that point did not identify a trade as suspicious, it would not be flagged for subsequent additional review by the Control Group.<sup>9</sup> According to Morgan Stanley’s written policies, including the

---

<sup>9</sup> There are certain circumstances in which other additional review was possible. First, certain of Morgan Stanley’s business units, including those that are most commonly in possession of material nonpublic information, utilized a pre-clearance process whereby an employee would have to seek clearance before conducting certain securities trading. As a result, some trades that appeared on the daily Watch List surveillance reports would have been separately



“Control Group Surveillance Manual,” in conducting this surveillance, the analyst is supposed to review firm proprietary, employee and employee-related trades in Watch List securities, as well as trading by certain employees who have discretion over trading in their clients’ accounts. The Manual stated that the “first step in conducting an effective review of the trading in Watch List securities is to understand the reason the issuer’s securities are on the Watch List.” This is necessary in order for the analyst to be able to identify the type of trade someone who might be misusing material nonpublic information would be expected to make. For example, the Manual stated that if Morgan Stanley has placed a company on the Watch List because the issuer is a target of an acquisition or merger, the trading activity to be aware of is, among other things, the “[p]urchase of stock” or the “[o]pening purchase of call options.”

In addition to the context of the trading activity, the Control Group Surveillance Manual contained a section that provided guidance for reviewing “Employee Trading.” That section stated that “[e]ach employee trade in a Watch List security is reviewed.” The section also stated that, “[i]n reviewing employee trading in Watch List securities, the following information should be considered:” This statement is followed in the Manual by a list of factors for the Control Group to consider in conducting surveillance, including (1) what department the employee works in, (2) whether the trade is made to initiate or close out a position, and (3) how the trade in question compares to the employee’s trading history – including whether the security has been traded before, the number of shares traded, the dollar amount invested, the holding period pattern, and whether the trade is in a security in an industry or of a type that the employee usually trades in.

Given the complexity of the process of seeking to determine, in the context of Morgan Stanley’s various securities business, whether a given employee or employee-related trade in a Watch List security may have been made improperly with the benefit of material nonpublic information, providing only a list of factors without any specific guidance regarding how or when they should be considered was inadequate written guidance. In practice, Control Group analysts did not consider all of the factors listed in the written policy when reviewing employee trading in Watch List securities. Ultimately, in the absence of sufficient guidance in Morgan Stanley’s written policies and procedures, it was left to the discretion of the individual analyst conducting surveillance to determine which factors, if any, to consider in the context of reviewing a particular trade.

## **2. Failures In Controls Regarding Watch List Maintenance**

Morgan Stanley’s process for placing an issuer on the Watch List suffered from inadequate controls. There are two steps in the process: (1) employees in the relevant Morgan Stanley business units are expected to notify the Control Group that they have or anticipate receiving material, nonpublic information pertaining to an issuer, and (2) the Control Group analyst determines whether the information is material and, if so, places the securities of the relevant issuer(s) on the Watch List. This process was not sufficiently maintained or enforced because it lacked certain controls in its

---

reviewed as part of the pre-clearance process. In addition, the Control Group reviewed a report designed to ensure that the pre-clearance process operated correctly. Accordingly, a subset of Watch List trades, those subject to the pre-clearance process, would receive this additional review. In addition, a given Watch List trade could be reviewed again separate from the daily review process by the Control Group if it was captured as part of a “Front Running” Surveillance report that the Control Group utilized when a Watch List security was moved to Morgan Stanley’s Restricted List.

implementation. First, there was no system of accountability to review that these steps were properly followed. Although employees were required under Morgan Stanley's Code of Conduct and certain other policies to notify the Control Group immediately with respect to developments that may affect the Watch List, Morgan Stanley lacked an adequate process for checking to ensure that all material transactions were reported to the Control Group. If employees failed to notify the Control Group of a material transaction or the fact that they possessed material nonpublic information regarding an issuer, the securities of the relevant issuer may have never made it onto the Watch List. Consequently, no Watch List surveillance would be conducted of trading in those securities.<sup>10</sup>

Second, historically, the Control Group analyst had sole discretion in determining whether a given transaction was material. Although the computer system default for transactions reported to the Control Group was to deem the transaction "material," if the analyst determined it was not, no Watch List coverage was initiated. (Morgan Stanley has since changed its procedures to include a review of all materiality determinations.) In addition, historically, the Control Group would not necessarily track the fact that it had been notified of a potentially material transaction if the analyst determined it was not material. Now, the procedures have been changed to track all notifications to the Control Group of a potentially material transaction, whether or not the transaction results in an issuer being placed on the Watch List.

## **E. LEGAL DISCUSSION**

Section 15(f) of the Exchange Act requires brokers and dealers registered with the Commission to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker's or dealer's business, to prevent the misuse in violation of the Exchange Act, or the rules or regulations thereunder, of material nonpublic information by such broker or dealer or any person associated with such broker or dealer. Section 204A of the Advisers Act requires certain investment advisers to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser's business, to prevent the misuse in violation of the Advisers Act or the Exchange Act, or the rules or regulations thereunder, of material nonpublic information by such investment adviser or any person associated with such investment adviser.

As described above, Morgan Stanley failed to maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of Morgan Stanley's business, to prevent misuse, in violation of the federal securities laws, of material nonpublic information by Morgan Stanley or any person associated with it. Although Morgan Stanley had written policies requiring that it conduct surveillance of trading in Watch List securities, Morgan Stanley failed to maintain and enforce those policies to the extent that it failed to conduct any surveillance with respect to hundreds of thousands of employee and employee-related accounts during a multi-year

---

<sup>10</sup> In certain circumstances, limited trading could still be subject to surveillance. Specifically, if a transaction caused an issuer to be placed on Morgan Stanley's Restricted List, a different company list maintained by the Control Group, the Control Group would typically perform "Front Running" surveillance. This surveillance captured certain trading for the two weeks prior to the placement of the company on the Restricted List and would capture trades that would have been reviewed on the daily Watch List surveillance reports for that two week period.

period. In addition, failures in the Control Group's procedures caused the Control Group not to review trading in any accounts with respect to some or all of the securities of approximately 3,000 issuers that were placed on the Watch List. These failures went virtually undetected and uncorrected by the Respondents for several years until the Respondents began to closely analyze their procedures in response to a Commission investigation. Moreover, certain of the written policies that Morgan Stanley had were inadequate because they failed to provide clear guidance with respect to aspects of Watch List surveillance.

The Commission has consistently made clear that broker-dealers and investment advisers must take seriously their responsibilities to design and enforce sufficiently robust policies and procedures to prevent the misuse of material nonpublic information. *See, e.g., In re Goldman, Sachs & Co.*, Exch. Act. Rel. No. 48436; Admin. Proceeding No. 3-11240 (September 4, 2003) (finding violations of Section 15(f)); *In re Gintel Asset Management, Inc., et al.*, Exch. Act Rel. No. 46798; Admin. Proceeding No. 3-10930 (November 8, 2002) (finding violations of Sections 15(f) and 204A); *In re DePrince, Race & Zollo, Inc., et al.*, Adv. Act Rel. No. 2035; Admin. Proceeding No. 3-10798 (June 12, 2002) (finding violations of Section 204A); *In re Guy P. Wyser-Pratte et al.*, Exch. Act Rel. No. 44283; Adv. Act Rel. No. 1943 (May 9, 2001) (finding violations of Section 15(f) and Section 204A); *In re Gabelli & Co., Inc. and Gamco Investors, Inc.*, Exch. Act Rel. No. 35057 (December 8, 1994) (finding violations of Section 15(f) and Section 204A). Taking into consideration the extensive trading and investment activities of the Respondents as broker-dealers and investment advisers, their policies and procedures were not reasonably designed to prevent the misuse of material nonpublic information and were not adequately maintained and enforced. The Respondents therefore willfully violated Section 15(f) of the Exchange Act and Section 204A of the Advisers Act.<sup>11</sup>

#### IV.

MS & Co. and MSDW have undertaken to:

A. Retain, within thirty (30) days of the issuance of this Order, at Respondents' expense, a qualified independent consultant (the "Consultant"), not unacceptable to the Commission staff, to (1) conduct a comprehensive review of Respondents' policies, practices and procedures relating to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act to determine the adequacy of such policies, practices and procedures and to prepare a Report, referenced below, reviewing the adequacy of the Respondents' current policies, practices, and procedures and making recommendations regarding how the Respondents should modify or supplement the policies, practices, and procedures to prevent the misuse of material nonpublic information in compliance with Section 15(f) and Section 204A; and (2) conduct a comprehensive review of Respondents' proposed methodologies and procedures for its Retrospective Surveillance Process, described below, to determine the adequacy of such methodologies and procedures, and to prepare a Report of the Consultant's findings on whether Respondents' proposed methodologies and procedures for their Retrospective Surveillance Process are reasonably designed to identify trades that occurred during

---

<sup>11</sup> "Willfully" as used in this Order means intentionally committing the act which constitutes the violation. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

the relevant period that were in violation of Respondents' policies against trading on the basis of material nonpublic information. Respondents shall provide a copy of the engagement letter detailing the Consultant's responsibilities to Richard W. Grime, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC, 20549-4631;

**B.** Cooperate fully with the Consultant, including providing the Consultant with access to its files, books, records, and personnel as reasonably requested for the above-mentioned reviews, and obtaining the cooperation of its employees or other persons under its control;

**C.** Require the Consultant to report to the Commission staff on his/her activities as the staff shall request;

**D.** Permit the Consultant to engage such assistance, clerical, legal or expert, as necessary and at reasonable cost, to carry out his/her activities, and the cost, if any, of such assistance shall be borne exclusively by Respondents;

**E.** Require the Consultant to complete his/her review of Respondents' policies, practices, and procedures relating to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act, and prepare, within one hundred and fifty (150) days of the issuance of this Order, unless otherwise extended by the staff for good cause, a written Report evaluating the adequacy of Respondents' policies, practices, and procedures relating to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act and making any recommendations about modifications thereto or additional or supplemental procedures deemed necessary to remedy any deficiencies described in the Report. The Consultant shall provide the Report simultaneously to both the Commission staff (at the address set forth above) and Respondents. Respondents shall afford the Consultant the option to seek an extension of time, for good cause shown, to submit the Report by making a written request to the staff at the address set forth above, a copy of which the Consultant shall provide to Respondents;

**F.** Within one hundred and twenty (120) days of Respondents' receipt of the Report, adopt and implement all recommendations set forth in the Report; provided, however, that as to any recommendation that Respondents consider to be, in whole or in part, unduly burdensome or impractical, Respondents may submit in writing to the Consultant and the staff (at the address set forth above), within sixty (60) days of receiving the Report, an alternative policy, practice, or procedure designed to achieve the same objective or purpose. Respondents and the Consultant shall then attempt in good faith to reach an agreement relating to each recommendation that Respondents consider to be unduly burdensome or impractical and the Consultant shall reasonably evaluate any alternative policy, practice, or procedure proposed by Respondents. Such discussion and evaluation by Respondents and the Consultant shall conclude within ninety (90) days after Respondents' receipt of the Report, whether or not Respondents and the Consultant have reached an agreement. Within fourteen (14) days after the conclusion of the discussion and evaluation by Respondents and the Consultant, Respondents shall require that the Consultant inform Respondents and the staff (at the address set forth above) of his/her final determination concerning any recommendation that Respondents consider to be unduly burdensome or impractical. Respondents shall abide by the determinations of the Consultant and, within sixty (60) days after final agreement between Respondents and the Consultant or final determination by the Consultant, whichever occurs first,

Respondents shall adopt and implement all of the recommendations that the Consultant deems appropriate;

**G.** Within fourteen (14) days of Respondents' adoption of all of the recommendations that the Consultant deems appropriate, Respondents shall certify in writing to the Consultant and the staff (at the address set forth above) that Respondents have adopted and implemented all of the Consultant's recommendations and that Respondents have established policies, practices, and procedures pursuant to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act that are consistent with this Order. Within sixty (60) days of the issuance of this Order, submit a written report (the "Retrospective Surveillance Methodology") simultaneously to the Consultant and the Commission staff (at the address set forth above) documenting the methodologies and procedures that Respondents propose to adopt and implement to complete a retrospective surveillance of trading in all accounts and all securities that should have been but were not surveilled by Respondents over the four (4) years prior to the date of the issuance of this Order (the "Retrospective Surveillance Process") to ascertain whether any trading has occurred in such accounts or securities in violation of Respondents' policies against trading on the basis of material nonpublic information; Require the Consultant to complete his/her review of Respondents' methodologies and procedures contained in the Retrospective Surveillance Methodology, and prepare, within thirty (30) days of the Consultant's receipt of the Retrospective Surveillance Methodology, unless otherwise extended by the staff for good cause, a written report (the "Retrospective Surveillance Methodology Review") evaluating the adequacy of Respondents' methodologies and procedures relating to Retrospective Surveillance and making any recommendations about modifications thereto or additional or supplemental methodologies or procedures deemed necessary to remedy any deficiencies described in the Retrospective Surveillance Methodology Review. The Consultant shall provide the Retrospective Surveillance Methodology Review simultaneously to both the Commission staff (at the address set forth above) and Respondents. Respondents shall afford the Consultant the option to seek an extension of time, for good cause shown, to submit the Retrospective Surveillance Methodology Review by making a written request to the staff at the address set forth above, a copy of which the Consultant shall provide to Respondents;

**H.** Within thirty (30) days of Respondents' receipt of the Retrospective Surveillance Methodology Review, adopt and initiate the implementation of all of the recommendations set forth therein; provided, however, that as to any recommendation that Respondents consider to be, in whole or in part, unduly burdensome or impractical, Respondents may submit in writing to the Consultant and the staff (at the address set forth above), within thirty (30) days of receiving the Retrospective Surveillance Methodology Review, an alternative methodology or procedure designed to achieve the same objective or purpose. Respondents and the Consultant shall then attempt in good faith to reach an agreement relating to each recommendation that Respondents consider to be unduly burdensome or impractical and the Consultant shall reasonably evaluate any alternative methodology or procedure proposed by Respondents. Such discussion and evaluation by Respondents and the Consultant shall conclude within sixty (60) days after Respondents' receipt of the Retrospective Surveillance Methodology Review, whether or not Respondents and the Consultant have reached an agreement. Within fourteen (14) days after the conclusion of the discussion and evaluation by Respondents and

the Consultant, Respondents shall require that the Consultant inform Respondents and the staff (at the address set forth above) of his/her final determination concerning any recommendation that Respondents consider to be unduly burdensome or impractical. Respondents shall abide by the determinations of the Consultant and, within thirty (30) days after final agreement between Respondents and the Consultant or final determination by the Consultant, whichever occurs first, Respondents shall adopt and initiate the implementation of all of the recommendations that the Consultant deems appropriate;

**I.** Within eighteen (18) months of Respondents' adoption of all of the recommendations that the Consultant deems appropriate, unless otherwise extended by the staff of the Commission for good cause shown, Respondents shall complete the Retrospective Surveillance Process in accordance with the Consultant's final recommendations. Within thirty (30) days of their completion of the Retrospective Surveillance Process, Respondents shall provide a written report (the "Retrospective Surveillance Report") simultaneously to the Commission's staff (at the address set forth above) and the Consultant certifying that Respondents have completed the Retrospective Surveillance Process in accordance with the Consultant's final recommendations, and providing the findings of the Retrospective Surveillance Process, provided, however, that Respondents shall provide promptly (but in any event within ten days) to the Commission staff information discovered during the completion of the Retrospective Surveillance Process tending to show that trading in violation of Respondents' policies against misuse of material nonpublic information occurred;

**J.** Respondents may apply to the Commission's staff for an extension of the deadlines described above before their expiration, and upon a showing of good cause by Respondents, the Commission's staff may, in its sole discretion, grant such extensions for whatever time period it deems appropriate;

**K.** To ensure the independence of the Consultant, Respondents shall not have the authority to terminate the Consultant without prior written approval of the Commission's staff, and shall compensate the Consultant and persons engaged to assist the Consultant for services rendered pursuant to this Order at their reasonable and customary rates;

**L.** Respondents shall require the Consultant to enter into an agreement that provides that, for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Consultant in the performance of his/her duties under this Order shall not, without the prior written consent of the Commission's staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such, for the period of the engagement and for a period of two years after the engagement;

**M.** Respondents agree to certify in writing to the staff (at the address set forth above), in the second year following the issuance of this Order, that Respondents have established and continue to maintain policies, practices, and procedures pursuant to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act that are consistent with this Order.

**V.**

In determining to accept the Offer, the Commission considered remedial actions taken by the Respondents and the cooperation they afforded the Commission staff. Once the initial problems in surveillance were discovered, Respondents conducted a review of their surveillance processes and began to take steps to correct the identified deficiencies. Respondents also cooperated with the staff in its investigation and timely reported their findings as additional surveillance issues were identified.

**VI.**

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Respondents and to impose the sanctions agreed to in Respondents' Offer.

**Accordingly, IT IS HEREBY ORDERED that:**

**A.** Pursuant to Section 15(b)(4) of the Exchange Act and Section 203(e)(5) of the Advisers Act, MS & Co. and MSDW be, and hereby are, censured;

**B.** Pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, MS & Co. and MSDW shall cease and desist from committing or causing any violations and any future violations, of Section 15(f) of the Exchange Act and Section 204A of the Advisers Act;

**C.** Within ten days of the issuance of this Order, MS & Co. and MSDW shall pay a civil money penalty in the aggregate amount of \$10,000,000 to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the Securities and Exchange Commission; (3) 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 (4) submitted under cover letter that identifies Morgan Stanley & Co. Incorporated and Morgan Stanley DW Inc. as Respondents in these proceedings, and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Richard W. Grime, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-4631; and

**D.** MS & Co. and MSDW shall comply with the undertakings enumerated in Section IV above.

By the Commission.

Nancy M. Morris  
Secretary