

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2008013782301**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Morgan Stanley & Co. Incorporated, Respondent
Member Firm
BD No.8209

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Morgan Stanley & Co. Incorporated ("Respondent," "Morgan Stanley," or the "Firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against the Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Morgan Stanley has been registered with FINRA since 1936. Morgan Stanley's principal place of business is in New York, New York and it has offices throughout the country. The Firm provides a full range of financial services to its retail and institutional clients, including publishing equity research reports. During the relevant period, Morgan Stanley annually published approximately 40,000 equity research reports and its analysts conducted hundreds of public appearances.

RELEVANT DISCIPLINARY HISTORY

Morgan Stanley has the following relevant disciplinary history:

On April 28, 2003, pursuant to Letter of Acceptance, Waiver and Consent No. CAF030025 FINRA found that Morgan Stanley violated NASD Rules 2110, 2210, and 3010 by failing to manage conflicts of interest between investment banking and research analyst operations,

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making undisclosed payments for research to other firms involved in an underwriting, and failing to supervise its research analysts (the "Research Analyst Settlement"). In connection with this settlement and similar settlements with the Securities and Exchange Commission ("SEC"), the NYSE and certain State regulators at the same time, Morgan Stanley agreed, among other things, to pay a total of \$125 million, consisting of a \$25 million fine, \$25 million as disgorgement, and \$75 million to be used for procurement of independent research. The Firm also agreed to certain undertakings.

On June 1, 2006, pursuant to AWC No. EAF0401500001, FINRA found that Morgan Stanley violated NASD Rules 2711 and 2110 by failing to identify in research reports published between March 2003 and July 2005 the percentage of securities to which the Firm would assign a "buy," "hold/neutral" or "sell" rating, and by not clearly and prominently disclosing "analyst industry view" ratings. FINRA also found that the Firm did not make certain disclosures in exchange traded fund reports in the manner required by SEC Rule 482(b)(5) of the Securities Act of 1933 and NASD Rule 2110. FINRA further found that Morgan Stanley did not establish and maintain supervisory procedures reasonably designed to ensure compliance with NASD Rules 2711 and 2110 and related SEC disclosure rules, and did not correct these deficiencies in a timely manner in violation of NASD Rules 3010 and 2110. Without admitting or denying FINRA's findings, Morgan Stanley agreed to a censure and a \$200,000 fine.

OVERVIEW

From April 2006 through June 2010, Morgan Stanley violated certain provisions of NASD's research analyst disclosure rule, Rule 2711, by publishing certain equity research reports that contained inaccurate disclosures regarding whether the research analyst or a member of the research analyst's household had a financial interest in the securities of the subject company and the nature of such financial interest, and whether the Firm (a) managed or co-managed a public offering for the subject company, (b) received or expected to receive compensation for investment banking services provided to the subject company, (c) received compensation for non-investment banking products or services provided to the subject company, or (d) acted as a market maker in the subject company's securities. Moreover, the Firm failed to include required price charts and disclosures regarding the Firm's valuation method used to generate target prices in certain equity research reports. Overall, these inaccuracies resulted in approximately 6,836 deficient disclosures in approximately 6,632 published research reports and 84 public appearances.

In addition, Morgan Stanley did not disclose in certain monthly account statements that the Firm had made available independent third-party research as required by the undertakings incorporated in the Research Analyst Settlement. This omission affected approximately 127,600 customer account statements issued between August 2007 and February 2008. As a result, the Firm violated NASD Rule 2110.

Morgan Stanley had inadequate policies and procedures to detect and prevent these violations. In particular, the Firm had inadequate systems in place to provide reasonable assurance that outside vendors and Firm employees were fulfilling their responsibilities for processing data required for research disclosures, and that research analysts were making appropriate disclosures in connection with certain equity research reports and public

appearances, in violation of NASD Rule 2711(i). Morgan Stanley's supervisory system also was not reasonably designed to detect that the Firm was not complying with its undertakings in the Research Analyst Settlement, in violation of NASD Rule 3010(a).

FACTS AND VIOLATIVE CONDUCT

A. Morgan Stanley Violated NASD Rule 2711

NASD Rule 2711(h) requires disclosure in research reports and public appearances of conflicts and potential conflicts stemming from, among other things, a member's or its research analysts' receipt of compensation from, ownership of securities in or other relationships with subject companies (collectively, the "required disclosures").

The Firm Inaccurately Reported Relevant Financial Interests in Subject Companies in Certain Research Reports

In relevant part, NASD Rule 2711(h)(1)(A) requires that a member firm disclose in an equity research report if the research analyst or a member of the research analyst's household has a financial interest in the securities of the subject company, and the nature of the financial interest.

Between November 2007 and June 2010, the Firm issued certain equity research reports that failed to disclose the financial interests of certain research analysts and a household member of a research analyst, in the securities of some subject companies covered in those reports. For example, between November 2007 and December 2008, the Firm issued equity research reports which failed to disclose that a registered research analyst owned shares of securities in two companies which were covered in those reports. Between March 2010 and June 2010, Morgan Stanley issued approximately 22 other equity research reports which failed to disclose that a member of another lead analyst's household and a junior analyst owned shares of securities in another company which was covered in those reports. By failing to properly disclose financial interests in the securities of subject companies held by its research analysts and a member of a research analyst's household, Morgan Stanley violated NASD Rule 2711(h)(1)(A).

The Firm Inaccurately Reported Whether it Received Investment Banking and Other Income From Subject Companies and Whether it Served as a Manager or Co-manager of an Offering For Subject Companies

NASD Rule 2711(h)(2) requires that a member firm disclose in an equity research report if it managed or co-managed a public offering of securities for the subject company within the past 12 months;¹ received compensation for investment banking ("IB") services from a subject company in the past 12 months, or expects to receive or intends to seek such compensation in the next 3 months;² received compensation for products or services other than IB from a subject company;³ is or was a client of the member during the 12-month period preceding the

¹ NASD Rule 2711(h)(2)(A)(ii)a.

² NASD Rule 2711(h)(2)(A)(ii)b and (ii)c.

³ NASD Rule 2711(h)(2)(A)(iii)a.

distribution of the research report, and if so, whether the services the member rendered were for IB, non-IB, or non-IB non-securities related services.⁴

Between April 2006 and March 2008, Morgan Stanley collected data used to generate these required disclosures from a variety of sources, including automated and manual data feeds. In February 2008, one of the automated data feeds used to generate the disclosure of the receipt or expected receipt of IB compensation was turned off for routine systems maintenance work and not restarted for approximately one month. As a result, the Firm's equity research disclosure system (the "disclosure system") captured stale data relating to IB income, leading the Firm to report receiving IB compensation from a subject company when it did not receive such compensation within the required reporting period, and not to report receiving IB compensation when it did. Moreover, an automated system implemented in August 2007 to identify companies that provided IB compensation to the Firm did not always capture such revenue when the subject company was identified by a trade name rather than its corporate name. As a result, the Firm in certain equity research reports did not report receiving IB revenue from companies when it received such compensation. These deficiencies caused inaccurate disclosures of the receipt of IB and non-IB revenue in approximately 238 equity research reports published between August 2007 and March 2008, in violation of NASD Rule 2711(h)(2)(A)(ii)(b), (2)(A)(ii)(c), and (2)(A)(iii)(b).

Morgan Stanley also inaccurately disclosed in certain equity research reports whether the Firm had managed or co-managed a public offering of securities for its subject companies. The Firm outsourced the process for generating these disclosures to a third-party vendor in March 2007. Soon after, the employee at the vendor responsible for part of the process ceased performing the task, but neither the vendor nor Morgan Stanley detected this until March 2008. As a result, the Firm both over- and under-reported whether it acted as a manager or co-manager of a public offering involving a subject company. The incorrect capture of data rendered approximately 3,410 equity research reports issued between March 2007 and March 2008 inaccurate, in violation of NASD Rule 2711(h)(2)(A)(ii)a.

Further, revenue from non-IB services and non-IB non-securities related services was incorrectly disclosed by the Firm in certain equity research reports published between April 2006 and March 2008. There were two causes for the incorrect disclosures. First, prior to April 2006, certain data used to generate these disclosures was captured by a manual data entry process performed by an employee in Morgan Stanley's Global Wealth Management Financial Control Group. When that employee left the Firm in April 2006, no one was reassigned to perform the task. As a result, new revenue information was not captured by the research disclosure system. Second, a data feed used to compile commodities revenue for the disclosure of non-IB non-securities related services incorporated outdated data, specifically, revenue that had been received more than 12 months earlier. The incorrect capture of revenue from non-IB and non-IB non-securities services affected approximately 885 research reports published between April 2006 and March 2008, in violation of NASD Rule 2711(h)(2)(A)(iii)a and (iii)b.

⁴ NASD Rule (2)(A)(iii)b.

Morgan Stanley Failed to Disclose Market Making Activity in Certain Equity Research Reports

NASD Rule 2711(h)(8) requires a member to disclose if it was making a market in securities issued by a subject company at the time a research report on the subject company was published.

Between January and September 2008, Morgan Stanley failed to disclose market making activity in certain equity research reports. Prior to January 2008, the Firm only made markets in Nasdaq-listed securities and, accordingly, the disclosure system only captured data on those securities for purposes of the market maker disclosure. Beginning in January 2008, the Firm began to enter proprietary quotations for securities listed on the NYSE and other exchanges, but the disclosure system was not updated until September 2008 to capture data for all exchanges and securities. As a result, Morgan Stanley did not report that it was a market maker for certain subject company's securities in approximately 2,025 equity research reports issued between January and September 2008, thereby violating NASD Rule 2711(h)(8).

Morgan Stanley Failed to Include Required Price Charts in Certain Equity Research Reports

NASD Rule 2711(h)(6) requires members to include a price chart in an equity research report if the research report contains either a rating or a price target, and the member has assigned a rating or price target to the subject company's securities for at least one year.

In a sample of 45 equity research reports issued by the Firm between April 2006 and January 2009, approximately 36 reports omitted the required price chart. Instead of properly including the price chart in these reports, the Firm provided a link to a separate website, violating NASD Rule 2711(h)(6).

Morgan Stanley Did Not Properly Disclose Valuation Methodology to Support Price Targets in Certain Equity Research Reports

NASD Rule 2711(h)(10) provides that disclosures must be clear, comprehensive and prominent. NASD Rule 2711(h)(7) provides that, if a research report contains a price target, the member must disclose the valuation methods used to determine that price target. Price targets must have a reasonable basis and must be accompanied by a disclosure concerning the risks that may impede achievement of the price target.

In lieu of discussing valuation methodology, the Firm had a practice of providing the following language in certain equity research reports: "For a discussion, if applicable, of the valuation methods used to determine price targets included in this summary and the risks related to achieving these targets, please refer to the *latest relevant published research on these stocks*" (emphasis added). This language was unclear and thus did not comply with NASD Rule 2711(h)(10). Further, a number of equity research reports failed to include any disclosure relating to the valuation method used to support a published price target, in violation of NASD Rule 2711(h)(7).

B. Morgan Stanley Failed to Disclose the Availability of Independent Third-Party Research in Certain Monthly Account Statements

Among the undertakings incorporated in the Research Analyst Settlement, Morgan Stanley agreed to provide both Morgan Stanley and independent third-party research ratings as well as disclosures concerning the availability of third-party independent research for companies referenced, in periodic account statements.⁵

From August 2007 to June 2008, while these undertakings were in effect, the Firm omitted specific Morgan Stanley and independent third-party research ratings and disclosures concerning the availability of third-party independent research from monthly account statements for new accounts in its Morgan Stanley Advisory Program ("MSA"). As a result, approximately 127,600 account statements did not contain disclosures required by the Research Analyst Settlement. Accordingly, the Firm violated NASD Rule 2110.

C. Morgan Stanley Failed to Implement Adequate Supervisory Systems and Procedures Relating to Research Disclosures and Independent Research Disclosure

NASD Rule 3010(a) requires firms to establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations. NASD Rule 2711(i) requires firms to adopt and implement written supervisory procedures reasonably designed to ensure compliance with the disclosure requirements of NASD Rule 2711.

Morgan Stanley failed to take adequate steps to ensure compliance with its undertaking described above, in violation of NASD Rule 3010(a). The Firm also violated NASD Rule 2711(i) by failing to conduct adequate follow-up and review to ensure that its employees or its third party vendors were adequately performing their delegated responsibilities for collecting data needed to generate accurate disclosures. Thus, the Firm did not detect that it was not adequately disclosing information regarding whether it had managed or co-managed a public offering of securities or whether it had received revenue from non-IB services and non-IB non-securities related services.

In addition, between April 2006 and March 2008, Morgan Stanley did not respond to certain indications that some equity research report disclosures were not correct. For example, emails during that time reflected that certain research analysts did not submit their periodic conflicts disclosures on a timely basis and did not always obtain advance approval for public appearances. This should have alerted the Firm that additional steps were required to confirm that its disclosures were accurate. Moreover, although the Firm had received written notice of certain personal financial interests of a registered research analyst, these interests were not properly disclosed in certain public appearances and equity research reports published by the Firm.

⁵ Section III.i. of Addendum A to the Final Judgment in *SEC v. Morgan Stanley & Co. Incorporated*, 03 CV 2948 (S.D.N.Y.), Lit. Release No. 18117, 2003 SEC LEXIS 1003 (April 28, 2003); AWC No. CAF030025 (April 24, 2003); and NYSE HPD 03-69 (April 22, 2003).

OTHER FACTORS

In determining the appropriate sanction in this matter, FINRA's Enforcement Department considered Morgan Stanley's self-report following the discovery of certain violations of the NASD research analyst disclosure rules and certain subsequent remedial measures, including the retention of outside counsel to perform a review that led to the discovery of certain additional violations of NASD Rule 2711, as well as Morgan Stanley's prior disciplinary history and the additional violations of Rule 2711 discovered during the Staff's investigation.

B. The Firm also consents to the imposition of the following sanctions:

1. Censure; and
2. Fine in the amount of \$800,000.

Morgan Stanley further consents to undertake the following:

Morgan Stanley shall certify in writing to FINRA's Enforcement Department within 60 days of the date of the AWC that it has fully implemented certain enhanced processes, procedures, and systems relating to its research analyst disclosures.

Morgan Stanley shall continue to monitor its research reports and public appearances by its research analysts. The Firm shall also review a meaningful sample of its research reports and records of public appearances and shall provide the Staff, within 60 days of the date of the AWC, with a description of the methodology the Firm will employ to conduct this review. Thereafter, the Firm shall certify in writing to FINRA's Enforcement Department every six months following the date these sanctions become effective for a period of two years that, based on its review of a meaningful sample of its research reports and records of public appearances, the Firm has complied with the disclosure requirements of NASD Rule 2711(h). For good cause shown and upon receipt of a timely application, FINRA staff may extend the certification deadline set forth herein.

The Firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

The Firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against it;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Respondent specifically and voluntarily waives any right to claim bias or prejudice of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;

- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firm; and
- C. If accepted:
1. This AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;
 2. This AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

7/13/10
Date

Respondent
Morgan Stanley & Co. Incorporated

By: 
Eric Grossman
General Counsel of the Americas

Reviewed by: 
Counsel for Respondent
Nader H. Saichi, Esq.
Bingham McCutchen LLP
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212-705-7000 (Phone)
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Accepted by FINRA:

Date

Signed on behalf of the
Director of ODA, by delegated authority

James E. Day
Associate Vice President and Chief Counsel
FINRA Department of Enforcement
1801 K Street, NW -- Suite 800
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202-974-2917 (Phone)
202-721-8303 (Facsimile)

Date

Respondent
Morgan Stanley & Co. Incorporated

By: _____
Eric Grossman
General Counsel of the Americas

Reviewed by:

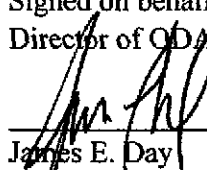
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Accepted by FINRA:

8/9/10

Date

Signed on behalf of the
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