

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 55726 / May 9, 2007**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12631**

**In the Matter of**

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

**Respondent.**

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

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Morgan Stanley & Co. Incorporated ("MS & Co." 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 him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

### III.

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

#### Summary

1. This matter arises from MS & Co.'s failure to provide best execution to certain retail orders for over-the-counter ("OTC") securities during the time period of October 24, 2001, through December 8, 2004 (hereinafter the "relevant time period"). MS & Co., as a broker-dealer, had a legal duty to seek to obtain for its retail customers' orders the most favorable terms reasonably available under the circumstances, taking into account price, order size, trading characteristics of the security, speed of execution, clearing costs, and the cost and difficulty of executing an order in a particular market, as well as the potential for price improvement (i.e., best execution).

2. MS & Co. breached the duty of best execution on certain retail OTC orders in three ways. First, on October 24, 2001, MS & Co. embedded undisclosed mark-ups and mark-downs<sup>2</sup> on certain not held<sup>3</sup> retail orders without retail customers' prior consent to do so.<sup>4</sup>

3. Second, MS & Co. developed and implemented a trading mechanism that sometimes slowed down the execution of orders so that MS & Co. could try to obtain price improvement for not held orders. The new trading mechanism improperly delayed the execution of certain held market orders for which MS & Co. had an obligation to execute without hesitation as required.

4. Third, MS & Co. embedded undisclosed mark-ups and mark-downs on certain retail orders for OTC stocks in which it made a market but filled with executions from other market centers (the "Street"). Such executions should have been passed along to retail customers' orders "print-for-print," which means those should have received the same execution prices that MS & Co. received from the Street without any mark-ups, mark-downs, commissions or other fees. MS & Co.'s practice was not consistent with its obligations to its retail customers' orders or its internal compliance policies.

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<sup>1</sup> 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.

<sup>2</sup> Mark-ups are added to the current offering price of a security and mark-downs are subtracted from the current bid price of a security by a dealer acting as a principal.

<sup>3</sup> Not held orders are orders for which the customer gives the broker time and price discretion. The customer vests the broker with the discretion as to when and at what price to buy or sell the stock. In contrast, held market orders are orders that a broker must execute without hesitation at the prevailing market price because it does not have time and price discretion.

<sup>4</sup> This matter only involves retail orders, not institutional orders. In 2001, the NASD rules permitted broker-dealers to embed undisclosed mark-ups and mark-downs (i.e., trade on a net basis) on institutional orders provided that the institutional customers consented. MS & Co. obtained such consent through negative consent letters.

5. During the relevant time period, MS & Co. failed to provide best execution to approximately 1,253,666 executions (3.7% of its OTC executions) valued at \$7,957,019,712.

6. MS & Co. recognized revenue of approximately \$5.95 million through its improper use of undisclosed mark-ups and mark-downs on not held orders and held market orders.

### **Respondent**

7. MS & Co. 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 of the Exchange Act, and is a member of self-regulatory organizations including NASD and the 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.

### **MS & Co.'s Market Making Activities**

8. During the relevant time period, MS & Co. was registered as a Nasdaq market maker in approximately between 500 and 2,100 stocks. While MS & Co. primarily served institutional customers during the relevant time period, it also executed orders placed by its retail customers serviced by its Private Wealth Management ("PWM") unit, and retail orders routed to it from its retail broker-dealer affiliate and other third party broker-dealers on behalf of their retail customers. To facilitate retail order flow from retail broker-dealers, MS & Co. made itself accessible to third-party retail broker-dealers via automatic, electronic connectivity to its market-making systems. These broker-dealers thereby automatically routed retail orders directly to MS & Co. for execution.

9. Historically, MS & Co. used a third party software package to facilitate its market making activities. The third party software package automated a portion of these activities, but still required a trader to manually handle and process many orders. In 2000, MS & Co. decided to improve the efficiencies of its market making business by developing a new market-making system (the "market-making system"). MS & Co. assembled a cross-divisional team to develop this system. The new system initially supplemented the third party software package by making markets in stocks in which MS & Co. did not currently make a market and eventually replaced the third party software package. The market-making system was intended to replace and improve upon the third party software package's order handling processes. The market-making system executed orders in the same general manner as the third party software package but with more automation. MS & Co. viewed its market-making system as a distinct improvement over the third party software package because, among other reasons, it could execute orders at much faster speeds. During the relevant time period, this system processed approximately 34 million executions valued at \$476 billion.

10. When MS & Co. decided to fill a customer's order on a riskless principal basis, *i.e.*, with executions from the Street, it routed an identical order to the Street for execution (hereinafter

"Street Executions").<sup>5</sup> MS & Co. referred to the price at which the Street executed the order as the "execution price." After receiving shares for the customer's order from the Street, the market-making system then filled the customer order by "flipping" the street execution to the customer. MS & Co. referred to the price at which the customer order was filled as the "flip price." For various reasons, the flip price may not have been the same as the execution price. When the market-making system filled the customer order at the same price, MS & Co. (consistent with industry practice) referred to the trade as giving "print-for-print."

11. MS & Co.'s internal compliance policy stated that when a customer order was filled with Street Executions the customer should get print-for-print. More specifically, MS & Co.'s policy expressly provided that "if a better price was obtained [from the Street] the Firm must pass the benefits of those executions on to the customer." This policy was not limited to orders received from PWM customers.

12. In addition, MS & Co. told certain third-party retail broker-dealers that it would seek to obtain best execution for retail orders routed to it by those broker-dealers and that it would not charge any mark-ups, mark-downs, commissions or other fees on those routed orders. The term "retail customers" refers to customers of MS & Co.'s PWM unit, retail customers of MS & Co.'s retail broker-dealer affiliate and retail customers of other third-party broker-dealers who routed orders to MS & Co. for execution.

### **MS & Co. Initially Programmed Its Market-Making System Not to Give Print-for-Print**

13. Contrary to MS & Co.'s best execution obligations, its internal policies and its historical practices, when MS & Co. developed the market-making system, it initially failed to program the system to properly handle Street Executions for retail orders. The initial coding was designed to ensure that customers received execution prices that did not exceed the National Best Bid or Offer ("NBBO") and also permitted MS & Co. to add a mark-up or mark-down to certain transactions. This resulted, in certain instances, in Street Executions being marked-up or marked-down. As a result, retail customers could have received inferior executions either because MS & Co. did not pass along the benefit of a superior execution or because the market had moved between the time of execution and the time of comparison.

14. MS & Co. began using the market-making system in late May 2001, to make a market in a handful of stocks. Soon thereafter, during a testing phase, the Compliance Department compared the order handling functions of the market-making system to the order handling functions of the third party software package. During the review, Compliance discovered that the market-making system would not pass along Street Executions print-for-print.

15. On or about June 14, 2001, MS & Co. reprogrammed the market-making system to ensure it passed along Street Executions print-for-print. Because no order actually failed to receive

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<sup>5</sup> A riskless principal trade is a trade in which a broker-dealer, after having received an order to buy (sell) a security, buys (sells) the security from (to) another person and sell (buys) the security to (from) the person who placed the order at the same price.

print-for-print as a result of the programming issue described above during the short time it was in place, MS & Co. did not recognize additional revenue as a result of the code.

### **MS & Co. Added Undisclosed Mark-ups And Mark-downs to Certain Retail Not Held Orders**

16. In the Fall of 2001, MS & Co. developed a new trading mechanism to automatically trade certain orders that MS & Co. had traditionally used traders to execute manually. Instead of executing the entire order at once, the new trading mechanism executed portions of the order over a period of time so as to lessen the market impact thereby possibly getting price improvement on the average price given to the customer.

17. On October 24, 2001, MS & Co. introduced the new trading mechanism and traders used it for not held orders. In order to charge a mark-up or mark-down on those not held orders processed by the new trading mechanism, MS & Co. also changed the way the market-making system passed Street Executions with respect to not held orders. The flip price for a not held order depended on the type of customer. There were two options for determining a not held execution price. Under the first option, the trading system passed the trade to the customer "print-for-print," without any embedded mark-up, mark-down, commission or other fee. Under the second option, the market-making system passed the trade to the customer at the current NBBO, regardless of the execution price received by MS & Co. (hereinafter the "Fill at the Inside" Instruction). In this case, if MS & Co. received a better execution price, the customer received the current NBBO and MS & Co. realized a mark-up or mark-down on the trade. Embedding a mark-up or mark-down in this situation is proper if the customer consents or if it is disclosed and the customer does not object.

18. During the relevant time period, the option for retail customers on their not held orders was "Fill At The Inside" despite the fact that MS & Co. had never made appropriate disclosure or received consent from them to embed a mark-up or mark down in their orders. Accordingly, MS & Co. breached its duty of best execution by embedding mark-ups and mark-downs on its retail not held orders.

### **MS & Co. Failed to Execute Certain Held Market Orders Without Hesitation**

19. On or about December 10, 2001, MS & Co. caused certain retail held market orders to be processed by the new trading mechanism that sometimes delayed executions. Absent disclosure to the contrary, when broker-dealers accept held market orders, they agree to execute them without hesitation at the prevailing market price even if a delay would result in a better price for the customer. A broker-dealer has no discretion with respect to such orders. More specifically, MS & Co. caused held market orders to be processed through the trading mechanism. As a result, the executions of certain market held orders that should have been executed without hesitation were delayed. Accordingly, MS & Co. breached its duty of best execution by not executing all of its retail held orders without hesitation.

### **MS & Co. Added Undisclosed Mark-ups And Mark-downs to Certain Retail Held Orders**

20. Also on December 10, 2001, MS & Co. changed the way the market-making system passed Street Executions on held orders without display obligations.<sup>6</sup> MS & Co. referred to this new programming code as "Capture Spread for Non-Display Held Orders" (hereinafter the "Code").<sup>7</sup> The Code had an effect on executions that was similar, but not identical, to the effect of the code in the initial version of the market-making system that Compliance had identified as being problematic and was removed.

21. After December 10, 2001, MS & Co. did not pass along Street Executions to certain retail customers' held orders print-for-print. For held market buy orders, the market-making system compared the execution price MS & Co. received from the Street to the National Best Offer ("Best Offer") at the time of the comparison. If the execution price was less than the Best Offer, MS & Co. passed the execution to the customer order at the best offer price and MS & Co. retained the difference between the execution price and the Best Offer. For example, if MS & Co. received an execution price of 10.00 on a buy order and the Best Offer at the time of comparison was 10.01, MS & Co. passed the trade to the customer at 10.01 and MS & Co. recognized an undisclosed mark-up of 0.01.

22. For held market sell orders, the market-making system compared the execution price MS & Co. received from the Street to the National Best Bid ("Best Bid"). If the execution price was greater than the Best Bid, MS & Co. passed the execution to the customer order at the Best Bid and MS & Co. retained the difference between the execution price and the Best Bid. For example, if MS & Co. received an execution price of 10.01 on a sell order and the Best Bid at the time of comparison was 10.00; MS & Co. gave the customer an execution price of 10.00 and MS & Co. recognized an undisclosed mark-down of 0.01.

23. Although MS & Co.'s market-making system was extremely fast, in an active market the Best Bid and Best Offer can change between the time of execution and the time of comparison, which may have been only one second or less. Therefore, the Code not only prevented certain retail customers from receiving the benefit of superior Street Executions, it also sometimes resulted in customers receiving prices worse than what was reasonably available at the time of execution. Thus, MS & Co. breached its duty of best execution by not giving certain retail customers the same prices it received from the Street.

24. In summary, the application of the "Fill-At-The-Inside" Instruction to certain retail not held orders, the use of the trading mechanism to execute certain retail held market orders, and

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<sup>6</sup> Display obligations refer to a market maker's obligation to "display" a customer limit order to the market. Market makers "display" such limit orders by publishing certain orders' limit prices to the market or routing them to another market maker or qualified ECN for display purposes. Market orders, held or not held, are not required to be displayed as they do not carry any price restrictions.

<sup>7</sup> The Code affected held market orders.

the retention of differences between execution price and the Best Bid or Best Offer certain retail held orders caused by the Code resulted in MS & Co.'s failure to provide best execution to certain retail customers' orders during the relevant period.

**MS & Co. Failed to Prevent or Timely  
Correct the Best Execution Problems**

25. MS & Co. was reckless in not knowing that, contrary to its representations and compliance policies, it did not provide best execution to certain retail customer orders.

26. As discussed above, Compliance professionals assisted and provided business managers with advice in connection with the development and implementation of the market-making system and discovered that the system was initially programmed incorrectly. Notwithstanding this initial discovery, MS & Co. had no procedure requiring Compliance's approval of changes to the market-making system by Information Technology personnel. As a result, Compliance's knowledge and understanding of specific programming changes, and their intended and actual effects, was either incomplete or non-existent. The supervisor involved with developing the new trading mechanism and flipping process believed that the computer programmers contacted Compliance for approval. The programmers believed that any requests for changes received from the supervisor had been previously approved by Compliance. In fact, no one had sought Compliance approval. Had anyone done so, it is possible that the best execution failures could have been prevented or at least corrected.

27. MS & Co.'s oversight of programming changes to the market-making system during the relevant period mainly consisted of the testing of the programming changes by Information Technology personnel. They tested code changes before the changes were introduced into the production version of the market-making system to see whether the code accomplished what the programmer had set out to change. No test examined whether the system handled orders properly or whether the programmed functions had effects that could be inconsistent with MS & Co.'s duty of best execution.

28. Unless a problem arose in connection with a particular section of the code, no one other than the programmer responsible for writing the code reviewed the actual code. During the developmental phase of the market-making system, an experienced supervisor who understood and wrote code, reviewed the code written by programmers before the programmers entered it into the market-making system. This review process stopped sometime after MS & Co. started using the market-making system.

29. The programmers used comments throughout the code to explain the purpose of particular functions. These comments, which had no effect on the program, identified, in plain English, certain functions. No coding or programming knowledge was required to understand these comments. MS & Co. had no procedure requiring anyone from Compliance, Information Technology or the business unit to review these comments. If MS & Co. had such a procedure, it is possible that MS & Co. could have detected the Code earlier and MS & Co. could have prevented the best execution failures.

30. MS & Co. had a number of opportunities to identify and to correct the coding issues causing its best execution failures. For example, in December 2001, MS & Co. modified the Code to exclude agency orders. In May 2002, a new programmer who read the Code and understood that the code resulted in undisclosed mark-ups or mark-downs on certain held orders without display obligations modified the Code in order to bring the execution price out to four decimal places. The programmer did not bring the Code to anyone's attention because he believed that others were aware of it and its effect. In February 2003, MS & Co. again modified the Code to eliminate market-on-close orders.<sup>8</sup> None of these coding changes were approved by Compliance or required Compliance to look at the Code and its effect.

31. In early 2003, MS & Co. created a section within Compliance to deal with technology related issues. Compliance drafted a checklist addressing programming changes to MS & Co.'s systems. The checklist included guidelines as to when to seek Compliance approval. A representative from the business unit, finding the checklist too cumbersome to employ, rejected the use of the checklist as "unreasonable" and it was never implemented. Accordingly, MS & Co. continued to have no procedures for monitoring changes to the program.

32. In late 2003, MS & Co. removed the code that caused the delay in execution of held orders. The Code remained and continued to allow MS & Co. to wrongfully embed a mark-up or mark-down when it used Street Executions to fill retail held market orders without display obligations.

33. On or about July 26, 2004, MS & Co. changed the Code to reflect the fact that MS & Co.'s affiliated broker-dealer, Morgan Stanley DW, Inc. ("MSDW"), had agreed to pay a set annual fee to MS & Co. for handling its Nasdaq orders. Accordingly, the computer programmer was advised that since MSDW was going to pay this set fee, all executions had to be passed along print-for-print, but no reference was made with respect to how other retail broker-dealers' orders should be treated. Thus, MS & Co. reprogrammed the Code to exclude only MSDW orders from the Code.

34. In November 2004, Compliance met with computer programmers responsible for the market-making system to discuss a finding by NASD that MS & Co. was not properly reporting riskless principal transactions. The computer programmers told Compliance that the market-making system compared execution prices to the current NBBO and gave a different execution price to the customer if the execution price was different than the current NBBO. Focused on the reporting, Compliance personnel believed this to be solely a limit order protection (or "Manning")<sup>9</sup> issue and instructed the programmers to resolve the reporting issue only.

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<sup>8</sup> A "market-on-close" order is typically an order to buy or sell at the official closing price of the primary market on which a stock is listed.

<sup>9</sup> NASD Conduct Rule 2110, inclusive of Interpretive Material 2110, often referred to as the Manning rule, requires that market makers fill customer limit orders at prices equal or superior to that of the limit orders if the market maker, acting for itself, trades ahead of those limit orders at prices that could satisfy the limit orders. NASD IM 2110-2. During the relevant period, the Manning Rule only applied to limit orders, which have display obligations.

Compliance personnel did not draw the conclusion that certain orders were not being transmitted print-for-print and did not examine the issue further.

35. On December 1, 2004, a MS & Co. employee discovered certain riskless principal orders that had not been filled print-for-print. The differences between the execution prices and the flip prices were sub-pennies, and the employee was not aware that the Code was the cause. The employee brought the issue to the attention of a MS & Co. lawyer who advised that the issue needed to be understood and resolved promptly. The employee planned to address the problem as soon as MS & Co. finished its preparations for the new Nasdaq Single Price Opening, which was to be rolled out in early December.

### **MS & Co. Removed The Code and the "Fill at the Inside" Instruction**

36. On December 8, 2004, unusually volatile trading in a stock in which MS & Co. made a market resulted in a short-term trading profit of \$400,000 within the first few minutes of trading. This profit – like all the previous revenues caused by the Code – went into a short term risk account and appeared on the system of the trader responsible for that stock. The trader, who was not then actively trading that stock, noticed the unprecedented level of profit that morning and found the situation inexplicable. He immediately brought the facts to the attention of his manager and employees who provided system support for the market-making system. By mid-afternoon, a systems support employee discovered that the Code was responsible for the anomalous activity. MS & Co. immediately cancelled and rebilled the affected trades. MS & Co. changed the market-making system's code to eliminate any future mark-ups and mark-downs on retail held orders. MS & Co. also identified the existence of, and removed, the Instruction that caused undisclosed mark-ups and mark-downs on not held orders.

### **Legal Discussion**

37. A broker-dealer has a legal duty to seek to obtain best execution of customer orders.<sup>10</sup> Failure to satisfy the duty of best execution may constitute a violation of Section 15(c)(1)(A) of the Exchange Act, which makes it unlawful for any broker or dealer to "effect any transaction in . . . any security by means of any manipulative, deceptive, or other fraudulent device or contrivance."<sup>11</sup>

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<sup>10</sup> See, e.g., Newton v. Merrill, Lynch, Pierce, Fenner & Smith, 135 F.3d 266, 269-70, 274 (3d Cir. 1998) (finding Merrill Lynch may have failed to maximize the economic benefit to its customers by failing to take advantage of prices better than the NBBO); In re Herzog, Heine, Geduld, LLC, Exchange Act Release No. 54148 (July 14, 2006) 2006 WL 1982741, at \*5; In re Certain Market Making Activities on Nasdaq, Exchange Act Release No. 40900 (Jan. 11, 1999), 1998 WL 919673, at \*5; see also Geman v. SEC, 334 F.3d 1183, 1192-93 (10<sup>th</sup> Cir. 2003) (finding that broker-dealer violated its duty of best execution by failing to disclose that its method of executing orders deprived customers of the possibility of getting a price better than the NBBO); Regulation NMS, Exchange Act Release No. 51808, 70 Fed Reg. 37,496, 37,538 (June 9, 2005).

<sup>11</sup> See In re Herzog, Heine, Geduld, LLC; Exchange Act Release No. 54148; In re Knight Securities, L.P., Exchange Act Release No. 50867, 2004 WL 2913488, at \*8 (Dec. 16, 2004).

38. As described above, between October 24, 2001, and December 8, 2004, MS & Co. failed to seek to obtain best execution for certain orders for OTC securities placed by retail customers of MS & Co., MSDW and third party broker-dealers that routed orders to MS & Co. for execution. These best execution failures occurred because: (a) the Fill-at-the-Inside Instruction resulted in undisclosed mark-ups and mark-downs on certain not held retail orders filled at the NBBO when the orders should have been filled print-for-print; (b) the trading mechanism delayed the execution of certain retail held orders which should have been executed without hesitation; and (c) the Code resulted in undisclosed mark-ups and mark-downs on certain held market orders when the orders should have been filled print-for-print. MS & Co. acted recklessly in not knowing that this conduct resulted in MS & Co. breaching its duty of best execution with respect to the affected orders. Accordingly, MS & Co. willfully violated Section 15(c)(1)(A) of the Exchange Act.

### **Remedial Efforts**

39. In determining to accept the Offer, the Commission considered remedial actions by the Respondent. Among other things, following the discovery of the Code, MS & Co. performed an internal investigation into the matter and enhanced its supervision and controls over the relevant trading technology.

### **Undertakings**

40. MS & Co. undertakes the following:

#### **Independent Compliance Consultant**

- a. MS & Co. shall retain, within 60 days of the date of entry of the Order, the services of an Independent Compliance Consultant ("ICC") not unacceptable to the staff of the Commission. The ICC's compensation and all related expenses shall be borne exclusively by MS & Co. MS & Co. shall require the ICC to conduct a comprehensive review of MS & Co.'s automated retail order handling practices to ensure that MS & Co. is complying with its duty of best execution to retail customers' orders. This review shall include, but should not be limited to, a review of MS & Co.'s market-making system's order handling procedures and MS & Co.'s controls relating to changes to those procedures. MS & Co. shall cooperate fully with the ICC and shall provide the ICC with access to its files, books, records, and personnel as reasonably requested for the review.
- b. At the conclusion of the review, but no later than 120 days from the date of entry of this Order, MS & Co. shall require the ICC to submit a Report to MS & Co. and the staff of the Commission. The Report shall address the issues described in paragraph a. of these undertakings and shall include a description of the review performed, the conclusions reached, the ICC's recommendations for changes in or improvements to MS & Co.'s policies and procedures and a procedure for implementing the recommended changes in or improvements to such policies and procedures.

- c. MS & Co. shall adopt all recommendations contained in the Report of the ICC; provided, however, that within 150 days from the date of entry of the Order, MS & Co. shall in writing advise the ICC and the staff of the Commission of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that MS & Co. considers unnecessary or inappropriate, it need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose.
- d. As to any recommendation with respect to MS & Co.'s policies and procedures on which it and the ICC do not agree, MS & Co. shall attempt in good faith to reach an agreement within 180 days from the date of entry of the Order. In the event MS & Co. and the ICC are unable to agree on an alternative proposal acceptable to the staff of the Commission, MS & Co. shall abide by the determinations of the ICC.
- e. MS & Co.: (i) shall not have the authority to terminate the ICC, without the prior written approval of the staff of the Commission; (ii) shall compensate the ICC, and persons engaged to assist the ICC, for services rendered pursuant to the Order at their reasonable and customary rates; and (iii) shall not be in and shall not have an attorney-client relationship with the ICC and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the ICC from transmitting any information, reports, or documents to the Commission or the Commission's staff.
- f. MS & Co. shall require the ICC to enter into an agreement that provides that for the period of the engagement and for a period of two years from completion of the engagement, the ICC shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with MS & Co., or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the ICC will require that any firm with which the ICC is affiliated or of which he is a member, and any person engaged to assist the ICC in performance of his duties under the Order shall not, without prior written consent of the Philadelphia District Office enter into any employment, consultant, attorney-client auditing or other professional relationship with MS & Co., or any of its 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.

### Independent Distribution Consultant

- g. MS & Co. shall retain, within 60 days of the date of entry of the Order, the services of an Independent Distribution Consultant ("IDC") not unacceptable to the staff of the Commission. The IDC's compensation and all related expenses shall be borne exclusively by MS & Co. MS & Co. shall require that the IDC develop a Distribution Plan for the distribution of the disgorgement ordered in Paragraph IV.C. of the Order, and any interest thereon, according to a methodology developed in consultation with MS & Co. and acceptable to the staff of the Commission. The Distribution Plan shall address how such monetary sums shall be distributed to recompense customers whose orders were adversely affected by the Instruction and the Code. MS & Co. shall cooperate fully with the IDC and shall provide the IDC with access to its files, books, records, and personnel as reasonably requested for review.
- h. At the conclusion of the review, which in no event shall be more than 120 days from the date of entry of the Order, MS & Co. shall require that the IDC submit a Distribution Plan to MS & Co. and the staff of the Commission. Within 150 days after the date of entry of the Order, MS & Co. or the staff of the Commission may advise, in writing, the IDC of any determination or calculation from the Distribution Plan that it considers to be inappropriate and states in writing the reasons for considering such determination or calculation inappropriate. With respect to any determination or calculation with which MS & Co. or the staff of the Commission do not agree such parties shall attempt in good faith to reach an agreement within 180 days of the date of entry of the Order. In the event that MS & Co. and the staff of the Commission are unable to agree on an alternative determination or calculation, the determinations and the calculations of the IDC shall be binding.
- i. Within 180 days of the date of entry of the Order, MS & Co. shall require that the IDC submit the Distribution Plan for the administration and distribution of disgorgement funds pursuant to Rule 1101 of the Commission's Rules Regarding Fair Fund and Disgorgement Plans. Following a Commission order approving a final plan of disgorgement, as provided in Rule 1104 of the Commission's Rules Regarding Fair Fund and Disgorgement Plans, MS & Co. shall require that the IDC with MS & Co. take all necessary and appropriate steps to administer the final plan for distribution of disgorgement funds. MS & Co. shall pay all costs and expenses of the distribution, including but not limited to, taxes and the expenses of the Plan Administrator and the Tax Administrator.
- j. MS & Co.: (i) shall not have the authority to terminate the IDC, without the prior written approval of the staff of the Commission; (ii) shall compensate

the IDC, for services rendered pursuant to the Order at their reasonable and customary rates; and (iii) shall not be in and shall not have an attorney-client relationship with the IDC and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the IDC from transmitting any information, reports, or documents to the Commission or the Commission's staff.

- k. MS & Co. shall require the IDC to enter into an agreement that provides that for the period of the engagement and for a period of two years from completion of the engagement, the IDC shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with MS & Co. or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the IDC will require that any firm with which he is affiliated or of which he is a member, and any person engaged to assist the IDC in performance of his duties under this Order shall not, without prior written consent of the Commission's Philadelphia District Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with MS & Co., or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity for the period of the engagement and for a period of two years after the engagement.

#### Certification

- l. MS & Co. agrees to certify in writing to the staff (at the address set forth herein), in the second year following the issuance of the Order, that MS & Co. has fully adopted and complied in all material respects with the undertakings set forth in paragraphs a. through k. above and with the recommendations of the ICC and IDC, or in the event of material non-adoption or non-compliance shall describe such material non-adoption and non-compliance.

#### Recordkeeping

- m. MS & Co. shall preserve for a period of not less than six years from the end of the fiscal year last used, the first two years in an easily accessible place, any record of its compliance with the undertakings set forth in paragraphs a. through k. above.

#### Extension of Time

- n. For good cause shown, the staff of the Commission may extend any of the procedural dates set forth above.

#### IV.

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

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

- A. MS & Co. is censured.
- B. MS & Co. shall cease and desist from committing or causing any violations and any future violations of Section 15(c)(1)(A) of the Exchange Act.
- C. MS & Co. shall, within 30 days of the entry of this Order, pay disgorgement in the amount of \$5,949,222, plus prejudgment interest thereon of \$507,978 for a total of \$6,457,200 to the Securities and Exchange Commission. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies MS & Co. as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Daniel M. Hawke, District Administrator, Division of Enforcement, Securities and Exchange Commission, Mellon Independence Center, 701 Market Street, Suite 2000, Philadelphia, PA 19106.
- D. MS & Co. shall, within 30 days of the date of entry of the Order, pay a civil money penalty in the amount of \$1.5 million to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the U.S. Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, U.S. Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under a cover letter that identifies MS & Co. as a respondent in these proceedings and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Daniel M. Hawke, District Administrator, Philadelphia District Office, U.S. Securities and Exchange Commission, Mellon Independence Center, 701 Market Street, Suite 2000, Philadelphia, PA 19106.

- E. MS & Co. shall comply with the undertakings enumerated in Section III.B.40 above.

By the Commission.

Nancy M. Morris  
Secretary