

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 78932 / September 26, 2016**

**INVESTMENT COMPANY ACT OF 1940**  
**Release No. 32286 / September 26, 2016**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17575**

**In the Matter of**

**NICHOLAS M. BONACCI**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 15(b) AND 21C  
OF THE SECURITIES EXCHANGE ACT OF  
1934 AND SECTION 9(b) OF THE  
INVESTMENT COMPANY ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”), against Nicholas M. Bonacci (“Bonacci” 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, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

### III.

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

#### **Summary**

These proceedings arise out of misleading conduct by Bonacci while he bought and sold residential mortgage-backed securities ("RMBS") as a trader at Morgan Stanley & Co., LLC ("Morgan Stanley"), a registered broker-dealer. Part of Bonacci's job involved arranging trades between Morgan Stanley's customers, meaning that he would buy a RMBS from one customer and then sell it to another customer. On certain occasions in 2012, Bonacci misled Morgan Stanley's customers with whom he was negotiating the sale of RMBS about the price at which Morgan Stanley had bought the RMBS and the amount of Morgan Stanley's compensation for arranging the trades. In certain circumstances, Bonacci also misrepresented that he was arranging a RMBS trade between customers, when Bonacci really was selling the RMBS out of Morgan Stanley's own inventory.

Many of Morgan Stanley's customers in these RMBS trades included investment advisers, primarily advisers to hedge funds, who owed fiduciary duties to their own clients. RMBS are generally illiquid, and market prices generally are not easily discoverable. In addition to fundamental valuation methods, participants in the RMBS market rely on informal sources, such as the dealer with whom they trade, for this information. Had Morgan Stanley's customers been aware of Bonacci's misrepresentations, and of the accurate facts relating to the trades they were negotiating, they would have made an effort to pay a lesser purchase price for the RMBS or less compensation to Morgan Stanley. As a result of this misconduct, Bonacci generated more revenue for Morgan Stanley.

#### **Respondent**

1. Nicholas Bonacci was a registered representative associated with Morgan Stanley beginning in July 2007. From that date to March 2014, Bonacci was employed as a trader on various securitized products desks, including the RMBS desk. Morgan Stanley placed Bonacci on administrative leave in March 2014. He resigned from Morgan Stanley in February 2016. Bonacci holds Series 7, 24 and 63 securities licenses. Bonacci is 31 years old and is a resident of New York, New York.

#### **Relevant Entity**

2. Morgan Stanley & Co., LLC is a Delaware limited liability company with its principal place of business in New York, NY. Morgan Stanley has been registered with the

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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 these or any other proceedings.

Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since 1970 and is a Financial Industry Regulatory Authority member.

### **Background**

3. Bonacci joined Morgan Stanley in July 2007 as a trader on Morgan Stanley's collateralized debt obligation desk, and then worked on its collateralized loan obligation desk. In or around December 2010, Bonacci joined Morgan Stanley's RMBS desk.

4. A RMBS is a type of fixed income product whose underlying assets are residential loans. RMBS are debt securities and sometimes are referred to as "bonds." Investors in RMBS receive payment from the interest and principal payments on the underlying mortgages. As a trader at Morgan Stanley, Bonacci arranged trades between buyers and sellers of RMBS and purchased and sold RMBS for and out of Morgan Stanley's inventory. In early 2013, Bonacci became co-head of Morgan Stanley's RMBS desk.

5. The market for RMBS is traded over the counter: there is no exchange that shows the buy and sell price for each trade as it occurs. Therefore, as a negotiation occurs, the buyer of the RMBS has no way to learn the price paid by the dealer unless learning it from the dealer.

6. RMBS are illiquid securities, and many of the RMBS that Morgan Stanley traded in 2012 traded at a significant discount to their face value following the 2008 financial crisis. The price of the RMBS is expressed as a percentage of its par value (the face value of a bond). A price of "100" means that the RMBS is trading at 100 percent of its par value. Similarly, a price of "80" means that the RMBS is trading at 80 percent of its par value.

7. Many of Morgan Stanley's customers were investment advisers who managed or advised funds and other entities that invested in RMBS. In its role as an intermediary, Morgan Stanley (through Bonacci and others) negotiated a purchase of a RMBS from one customer and the subsequent resale of that RMBS to another customer, sometimes on the same day. In those circumstances, where Bonacci had already identified a potential buyer, Morgan Stanley typically re-sold the RMBS on a principal basis, meaning that, Morgan Stanley would temporarily own the RMBS in a principal account. However, Morgan Stanley typically took little risk because it was likely to resell the RMBS to another customer shortly thereafter. One of the ways Bonacci generated profits for Morgan Stanley was by purchasing the RMBS from one customer and selling it to another customer at a higher price. Because Morgan Stanley collected the spread (or difference) between Morgan Stanley's purchase price from one customer and the sale price to another customer, Morgan Stanley's profit increased as the sales price for the RMBS increased. The customers were aware that Morgan Stanley was compensated in this way, and the amount and source of the compensation were typically part of the negotiations around the purchase and sale of the RMBS.

8. Bonacci sometimes offered the customers an "all-in" price for a RMBS that incorporated both the purchase price for the security and Morgan Stanley's compensation; on other

occasions, Bonacci and the customer agreed that Morgan Stanley's compensation would be in addition to, or "on top of," Morgan Stanley's disclosed acquisition price for the RMBS.

9. As was standard in the industry, Morgan Stanley's traders and their customers often discussed the RMBS price and the amount of Morgan Stanley's compensation in terms of the number of "ticks" that Morgan Stanley would receive on a trade. One "tick" equals 1/32 of a point (a point is one percent). For example, a price of 65-16 means 65 and 16 ticks (sometimes expressed as  $65^{16/32}$  or 65.5). Bonacci's communications with his customers often occurred electronically: by email, instant messaging, or online "chats."

10. The market for secondary trading in RMBS operates through relationships between customers, who buy and sell the bonds, and broker-dealers, like Morgan Stanley, that identify interested buyers and sellers and arrange the trades. Customers seek to pay the lowest price for purchases and get the highest price on sales. It is not unusual for a customer's information about the current market price for a security to come from the firm that is arranging the sale of the security. Because of this, there is an emphasis on establishing relationships, building trust, and having a good reputation within the industry. In part because of the opacity of the market, and because investment advisers owe fiduciary duties to their underlying clients, customers seek to avoid broker-dealers who are not honest with them.

### **Bonacci's Misconduct**

11. When Bonacci first joined the RMBS trading desk in 2010, he went through a period of training and spent several months shadowing RMBS traders to learn the market and relevant practices of the RMBS desk. In or around 2011, Bonacci began trading RMBS. During this time period, on occasion, he observed other traders engaging in questionable conduct with counterparties. In 2012, Bonacci made misrepresentations to counterparties on five identified occasions.

*January 11, 2012 DBALT 2006-AR6*

12. On January 11, 2012, Bonacci bought a DBALT 2006-AR6 bond for Morgan Stanley with the intention of marketing it that day. At 9:40 a.m., Bonacci purchased \$30 million notional, based on the original face amount, at 49-00, and at 10:20 a.m. he added \$10 million in original face amount notional, also at 49-00.

13. At 9:55 a.m., Bonacci misled a London hedge fund buyer ("Buyer A") by stating that "[I] also have a [money manager] showing me DBALT . . . at 50. . ." This was misleading because, 15 minutes earlier, Morgan Stanley had bought \$30 million for 49-00. Over the next few hours, Bonacci and a Morgan Stanley salesperson negotiated the sale to Buyer A.

14. At around 12:36 p.m., Buyer A bid 49-08. This bid would have earned Morgan Stanley an 8 tick, or quarter point, spread. Yet, Bonacci continued to negotiate as if he was dealing with an active seller of the bond rather than holding it in the firm's inventory.

15. Bonacci replied to the Morgan Stanley salesperson who was conducting most of the negotiations with Buyer A, advising him that the seller, which by then already had sold the bond to Morgan Stanley, “came back at 49-20.” The salesperson asked in response whether the 49-20 offering price included Morgan Stanley’s compensation. Although the sale had been completed several hours prior at the price of 49-00, Bonacci falsely responded to the salesperson, “I can prob ask for a couple ticks.” The salesperson relayed this misstatement to Buyer A.

16. Buyer A responded that he can pay 49-20 “but thats the maximum i can pay so i cant pay you guys out of there.” Having made a 20 tick spread on this trade, Bonacci agreed to this price and falsely claimed that the seller “will pay me.”

17. Bonacci’s misleading statements affected the purchase price by the Buyer A representative. The Buyer A representative would have attempted to obtain a lower price on the trade had he known the truth.

18. Because of Bonacci’s misleading statements to the Buyer A representative, Buyer A bought the bond for 49-20. Morgan Stanley received approximately \$127,500 in profits from this trade.

*July 11, 2012 RAMP 2006-RZ2*

19. At around 9:59 a.m., on July 11, 2012, a Morgan Stanley customer offered Morgan Stanley a RAMP 2006-RZ2 bond at the price of 55-00.

20. At 10:36 a.m., Bonacci began attempting to sell the bond to potential buyers, including a hedge fund buyer (“Buyer B”). Bonacci falsely told Buyer B that the bond was “offered to me at 57-16 from a [sic] client.”

21. Over the next couple of hours Bonacci negotiated with Buyer B. At each iteration, Bonacci misrepresented to Buyer B the price at which the bond was being offered to Morgan Stanley. At 12:34p.m., Buyer B bid 56-08, which was 40 ticks – or one and a quarter points – above the seller’s offering price. Despite that, Bonacci falsely told Buyer B that the seller countered at 56-16. Buyer B agreed to purchase the bonds at that purported offering price.

22. Morgan Stanley had purchased the bonds at 55-00. Bonacci’s misleading statements affected the purchase price by the Buyer B representative. The Buyer B representative would have attempted to obtain a lower price on the trade had he known the truth.

23. As a result of Bonacci’s misleading statements to the Buyer B representative, Buyer B bought the bond at 56-16. Morgan Stanley received approximately \$257,325 in profits from this trade.

*August 3, 2012 BCAP 2010-RR4*

24. On August 2, 2012, Bonacci began negotiating the purchase of BCAP 2010-RR4 5A13 from a hedge fund seller (“Seller C”), which Morgan Stanley ultimately bought and sold the next day to a hedge fund buyer (“Buyer C”).

25. At 9:00 a.m. on August 3, Bonacci asked Seller C, “may i operate with a firm order /81?” Seller C responded affirmatively, which indicated that he stood ready to sell the bond at 81-00. Bonacci and others at Morgan Stanley then offered the bond to a distribution list of potential buyers at 82-16.

26. At 12:28 p.m., Buyer C provided Bonacci with an 80-00 bid. A few minutes later Bonacci responded to Buyer C, “he said /82-08/.” This statement was false. Seller C had earlier agreed to transact at 81-00.

27. Shortly after that, Seller C lowered his offering price to 80-24. At 12:52 p.m., Buyer C bid 80-20. Ten minutes later, Bonacci continued to misrepresent Seller C’s offer and claim that the seller countered at 82-00. He informed Buyer C that he was “running out of room [for negotiations with the seller].”

28. Buyer C then engaged in a series of chats with Bonacci regarding Morgan Stanley’s compensation for the transaction. At 1:07 p.m., Buyer C asked if 82-00 was “all in” to him, i.e., whether it included Morgan Stanley’s compensation. Bonacci falsely claimed that it was not and proposed that 4 ticks be added to that purported offering price to compensate Morgan Stanley.

29. At 1:13 p.m., Buyer C raised his bid to 81-04, which was 12 ticks above Seller C’s offering price. At 1:38 p.m., Bonacci misrepresented to Buyer C that the seller is “hes [sic] 81-20.” Twenty minutes later, Bonacci, on behalf of Morgan Stanley, bought the bonds at 80-24. Several minutes after that, Buyer C agreed to purchase the bonds at the seller’s purported offering price of 81-20.

30. Bonacci’s misleading statements affected the purchase price by the Buyer C representative. The Buyer C representative would have attempted to obtain a lower price on the trade had he known the truth.

31. As a result of Bonacci’s misleading statements to the Buyer C representative, Morgan Stanley reaped an additional \$88,095 in profits.

*September 14, 2012 ECR 2005-3 M2*

32. On September 14, 2012, another trader at Morgan Stanley had bought a bond, ECR 2005-3 M2, for 84-16. Minutes later, Bonacci offered it to several potential buyers at 86-08, including to a hedge fund buyer (“Buyer D”). Bonacci further informed Buyer D that “i just bot so this is a tight reoffer.” A “tight reoffer” means that there is a small spread between the dealer’s purchase price and the price at which it is now offering the bond.

33. Buyer D bid 85-00. Bonacci then misrepresented to Buyer D that he “bot them higher...” Bonacci then lowered his offer to 86-04. After some negotiations, Buyer D agreed to buy the bonds at 86-04.

34. Bonacci’s misleading statements affected the purchase price by the Buyer D representative. The Buyer D representative would have attempted to obtain a lower price on the trade had he known the truth.

35. As a result of Bonacci’s misleading statements to the Buyer D representative, Morgan Stanley received approximately \$171,300 in additional profits.

*November 20, 2012 NHEL 2006-4 A2C*

36. On November 20, 2012, Bonacci was attempting to intermediate a trade of the bond NHEL 2006-4 A2C with a notional value of approximately \$44 million between a hedge fund seller (“Seller E”) and a large mutual fund buyer (“Buyer E”).

37. During the negotiations, Seller E offered to sell the bond to Morgan Stanley at 38-00. Bonacci then falsely told Buyer E that the seller “countered at 39-16.” After Buyer E countered with a bid of 37-02, Bonacci told Buyer E that “I got him to show 39-08,” when, in fact, Seller E still had his 38-00 offer available.

38. One minute later, Bonacci informed Seller E that Morgan Stanley would accept Seller E’s offer of 38-00, and Morgan Stanley purchased the bonds at that price.

39. The negotiations with Buyer E continued, and Bonacci misled Buyer E into thinking that Morgan Stanley was still negotiating the sale from Seller E. Bonacci falsely claimed that the seller “showed /39.” After several iterations, Bonacci told Buyer E, “i can buy them at 38-16.” This statement was false because it portrayed the negotiations with the seller as ongoing when Morgan Stanley had already purchased the bonds at 38-00 and also because it implied that Morgan Stanley would not receive any compensation at that price.

40. Although Buyer E responded with a bid of 38-08 – which would have earned Morgan Stanley an 8 tick, or quarter point, spread – Bonacci continued to negotiate in an effort to increase Morgan Stanley’s profit on the trade. Bonacci responded, “it was a repeat,” i.e., the seller was repeating its purported offer of 38-16.

41. Buyer E finally agreed to purchase the bond at this price. A salesperson at Morgan Stanley who was responsible for the customer relationship with Buyer E, and participated in the chats between Bonacci and the trader from Buyer E, then asked, “[N]ick is this flat to [yo]u?” In other words, the salesperson was asking whether Morgan Stanley was earning a spread at this price. The trader for Buyer E then also asked Bonacci, “[The seller] is paying you?” Although Morgan Stanley had earned 16 ticks, or half a point, on this trade, Bonacci responded to the

salesperson and Buyer E "... unlikely." In response, Buyer E offered to pay 4 ticks on top and purchase the bond at 38-20.

42. Bonacci's misleading statements affected the purchase price by the Buyer E representative. The Buyer E representative would have attempted to obtain a lower price on the trade had he known the truth.

43. As a result of Bonacci's misleading statements to the Buyer E representative, Buyer E bought the bond at 38-20. Morgan Stanley received approximately \$275,387 in profits from this trade.

44. As a result of the conduct described above, Bonacci willfully aided and abetted and caused Morgan Stanley's violations of Section 15(c)(1)(A) of the Exchange Act, which prohibits deceptive conduct by a broker or dealer in connection with the purchase or sale of securities.

45. In determining to accept the Offer, the Commission considered Respondent's cooperation and acknowledgement of responsibility for his misconduct.

#### **IV.**

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Bonacci cease and desist from committing or causing any violations and any future violations of Section 15(c)(1)(A) of the Exchange Act.

B. Respondent Bonacci be, and hereby is suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of twelve months, effective on the second Monday following the entry of this Order.

C. Respondent Bonacci is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, for a period of twelve months, effective on the second Monday following the entry of this Order.

D. Bonacci shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of \$100,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Bonacci as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Daniel Michael, Assistant Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 200 Vesey Street, Suite 400, New York, New York 10281.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in these proceedings. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order entered by the Commission in these proceedings.

F. Respondent acknowledges that the Commission is not imposing a civil penalty in excess of \$100,000 based upon his cooperation in a Commission investigation and related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission, or in a related proceeding, the Division may, at its sole discretion and with prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay an additional civil penalty.

Respondent may contest by way of defense in any resulting administrative proceeding whether it knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

**V.**

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with these proceedings, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields  
Secretary