ADMINISTRATIVE PROCEEDING

BEFORE THE

SECURITIES COMMISSIONER OF SOUTH CAROLINA

IN THE MATTER OF:	)	**COMPLAINT**
	)	
MORGAN STANLEY SMITH BARNEY, LLC	)	**File No. 10017**
(CRD #149777) as Successor to	)	
MORGAN STANLEY & CO.	)	
INCORPORATED (CRD #8209),	)	
	)	
Respondent.	)	

The Securities Division of the Office of the Attorney General of the State of South Carolina (the "Division") alleges that Morgan Stanley & Co. Incorporated ("Morgan Stanley"), prior to the merger that created Morgan Stanley Smith Barney, LLC ("Respondent"), engaged in acts, practices, and transactions which constitute violations of the South Carolina Uniform Securities Act of 2005 (the "Act"), S.C. Code Ann. §§ 35-1-101 to 35-1-703 (Supp. 2010), as set forth herein.

INTRODUCTION

1. This matter involves the offer and sale of auction rate securities by Morgan Stanley in situations where the sales were not suitable for the purchasing investors and under circumstances that constituted violations of the Act.

2. The time period covered by this Complaint (the "relevant time period" or "time period herein") is February 13, 2008, through December 31, 2008.

JURISDICTION

3. The Securities Commissioner of the State of South Carolina ("Commissioner") has jurisdiction over this matter pursuant to S.C. Code Ann. § 35-1-601(a).

4. The transactions at issue in this Complaint were effected by Morgan Stanley, through one or more of Morgan Stanley's registered agents and occurred in and from the State of South Carolina.

RESPONDENT

5. Respondent is the successor to Morgan Stanley.

6. Morgan Stanley was registered with the State of South Carolina as a broker-dealer during the relevant time period.

7. Morgan Stanley, individually or through its predecessors or successors, is registered with the State of South Carolina as a broker-dealer and has been registered as such since at least October 28, 1981.

8. Morgan Stanley, individually or through its predecessors or successors, currently has and has previously had multiple branch offices located in the State of South Carolina.

9. The branches offices in which the behavior occurred that is the subject of this Complaint are the Hilton Head and Greenville, South Carolina, offices of Morgan Stanley.

FACTUAL STATEMENT

Product and History

10. Auction rate securities are financial instruments that include auction rate preferred shares of closed-end funds, municipal auction rate bonds, and various asset-backed auction rate bonds (collectively referred to herein as "ARS").

11. ARS generally are long-term instruments which periodically pay interest or dividends, the rate of return on which is periodically reset.

12. Historically, the liquidity of auction rate securities with long-term maturities was maintained through the successful operation of a bidding process known as a Dutch auction.

13. Previous to the time period herein, Morgan Stanley, as well as other broker-dealers, traded ARS for both its clients and itself. The firms also supported the markets for ARS by bids designed to ensure successful auctions.

14. From the Fall of 2007 through February of 2008, demand for auction rate securities eroded, and Morgan Stanley's ARS inventory reached unprecedented levels.

15. Morgan Stanley became aware of the increasing strains in the ARS market and recognized the potential for widespread market failure.

16. In February, 2008, Morgan Stanley and other firms stopped supporting the auctions. Without the benefit of support bids, the auction rate securities market collapsed, leaving investors who had been led to believe that these securities were cash-alternative investments appropriate for managing short-term cash needs holding long-term securities that could not readily be liquidated at par value.

17. Investors in South Carolina who invested in ARS through Morgan Stanley prior to February 13, 2008, have since been made whole by Morgan Stanley pursuant to a Consent Order between the Securities Division and Morgan Stanley dated March 11, 2010.

Offers and Sales of ARS after February 13, 2008

18. Subsequent to the collapse of the ARS market and during the time period herein, Morgan Stanley participated in the marketing and sale of ARS.

19. Subsequent to the collapse of the ARS market and during the time period herein, Morgan Stanley, through registered agents ("Representatives"), advised one or more clients that certain ARS were safe, liquid investments.

20. During the relevant time period, Morgan Stanley Representatives recommended and sold ARS to retail investors who were seeking liquid investments.

21. Specific representations made by Morgan Stanley Representatives to clients include the representations that ARS are "just like cash" and "liquid with seven days notice."

22. At the time the representations, recommendations, and sales in items 19 to 21 were made, the ARS that Morgan Stanley's Representatives indicated were "safe, liquid investments" and offered and sold had significant liquidity risks associated with them.

23. During the relevant time period, Morgan Stanley Representatives recommended and sold ARS to retail investors who were seeking short-term investments.

24. Morgan Stanley, through its Representatives, represented the recommended ARS were suitable for investors seeking short-term investments.

25. In fact, the ARS recommended in items 23 and 24 are bonds with long-term maturities.

26. At the time of the recommendations in items 23 and 24, the ARS markets were facing unprecedented liquidity issues.

27. At the time of the recommendations in items 23 and 24, short-term liquidity of the ARS involved would not occur without either the ARS involved being called or the existence of a willing bidder.

28. One or more Morgan Stanley Representatives who made the representations in items 23 and 24 failed to disclose to their ARS customers with short-term liquidity needs that if the auction process failed, the customers might be unable to sell purchased ARS without a significant loss.

29. The same Representatives failed to inform their ARS clients that ARS auctions across the country had failed and were continuing to fail.

Firm's Failure to Train and Supervise

30. Morgan Stanley Representatives in one or more South Carolina branches have testified they continued to believe that certain ARS were liquid and safe investments through at least November, 2008.

31. One or more of these Morgan Stanley Representatives continued to market and sell ARS as liquid investments to South Carolina residents throughout 2008, with the last known sale in South Carolina occurring on or about October 30, 2008.

32. Subsequent to the collapse of the ARS market, Morgan Stanley did not adequately train its representatives in South Carolina regarding the potential illiquidity of ARS.

33. Specifically, Morgan Stanley did not tell its South Carolina representatives that (i) at times Morgan Stanley supported the market and (ii) Morgan Stanley could, at any time, stop supporting the market, resulting in a loss of liquidity for ARS which had been kept liquid through Morgan Stanley's and other broker-dealers' support of the market.

34. Subsequent to the collapse of the ARS market, Morgan Stanley did not take adequate steps to assure that sales of ARS were not made to retail customers without full disclosure of the risks and an appropriate suitability analysis first being performed.

APPLICABLE LAW

35. Morgan Stanley, both as a broker-dealer registered in South Carolina and as a federally registered securities dealer, is required to observe various standards of conduct in its dealings with South Carolina customers. These standards are found in the Act, in the rules adopted pursuant to the Act, in the Securities Exchange Act of 1934, and in rules imposed on Morgan Stanley by the SEC itself and through the authority of the SEC as granted to the FINRA.

36. Pursuant to S.C. Code Ann. § 35-1-412, broker-dealers conducting business in and from the State of South Carolina are required to reasonably train, instruct, and supervise their agents and all other individuals conducting securities business on their behalf. Similar standards are also imposed on registered securities dealers by 15 USC 78o(b)(4)(E) and NASD Rule 3010.

37. Morgan Stanley violated S.C. Code Ann. § 35-1-412 and NASD Rule 3010 when it failed to adequately train, instruct, and supervise its agents as to the liquidity of ARS and as to representations that were appropriate to be made concerning the liquidity of ARS.

38. Pursuant to S.C. Rule 13-501, broker-dealers conducting business in and from the State of South Carolina and their agents are obligated to determine the suitability of any investments recommended to customers based on reasonable inquiry and other relevant information. Similar standards are also imposed on registered securities dealers by NASD Rule 2310.

39. Morgan Stanley violated S.C. Rule 13-501 and NASD Rule 2310 when it, through its Representatives, did not determine the suitability of the ARS investments for clients to which it recommended the investments.

40. Pursuant to S.C. Code Ann. § 35-1-501, it is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly: (1) to employ a device, scheme, or artifice to defraud; (2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person. Similar standards are also imposed on registered securities dealers by 15 USC 78o(c)(2)(A), NASD Rule 2210, and FINRA Rules 2010 and 2020.

41. Morgan Stanley violated S.C. Code Ann. § 35-1-501 and 15 USC 78o (C)(2)(A), NASD Rule 2210, and FINRA Rules 2010 and 2020 when it, through its Representatives and in connection with the offer and sale of ARS Securities in and from South Carolina, omitted to state material facts regarding the securities, including facts relating to the liquidity and long-term nature of the securities.

42. The Commissioner has the authority, pursuant to S.C. Code Ann. § 35-1-412, to issue an order revoking, suspending, conditioning, or limiting the registration of a broker-dealer or investment adviser.

43. In a final order, the Securities Commissioner may impose a civil penalty not to exceed $10,000 for each violation of the Act, and may charge the actual cost of an investigation or proceeding for a violation against Respondent.

REQUESTED RELIEF

WHEREAS, Morgan Stanley's failure to reasonably train, instruct, and supervise its Representatives violates the Act; and

WHEREAS, Morgan Stanley's failure through its Representatives, to ascertain the suitability of ARS investments for its South Carolina customers to whom it recommended such investments violates the Act; and

WHEREAS, Morgan Stanley's omission of material facts regarding ARS during its course of dealing with South Carolina investors violates the Act; and

WHEREAS, it is necessary and appropriate, in the public interest, for the protection of investors, and consistent with the purposes fairly intended by the policy and provisions of the Act to seek to suspend, revoke, condition, and/or limit Morgan Stanley or any successor's registration as a broker-dealer in South Carolina until the Securities Division receives

verification that Morgan Stanley or its successor has policies in place to ensure such violations do not occur again in this State and, further, to impose a civil penalty not to exceed $10,000 per violation of the Act;

NOW, THEREFORE, the Division requests that the Commissioner grant the following relief against Respondent, as successor to Morgan Stanley:

a. Pursuant to S.C. Code Ann. § 35-1-604, order Respondent to pay an administrative fine in an amount not exceeding ten thousand and no/100 ($10,000.00) dollars for each violation of the Act and each violation of any rule or order promulgated by the Commissioner; and

b. Pursuant to S.C. Code Ann. § 35-1-604, order Respondent to reimburse the actual cost of the investigation and proceeding in the present case; and

c. Order any other relief that the Commissioner deems appropriate.

NOTICE AND OPPORTUNITY FOR A HEARING

NOTICE is hereby given that Respondent shall have thirty (30) days from the date of receipt of this Complaint to give written notice requesting a hearing on the matters contained herein to Thresechia Navarro, Securities Division, Post Office Box 11549, Columbia, South Carolina, 29211-1549. In the written Answer, Respondent, in addition to requesting a hearing, shall admit or deny each factual allegation in this Complaint, shall set forth specific facts on which Respondent relies, and shall set forth concisely the matters of law and affirmative defenses upon which Respondent relies. If Respondent is without knowledge or information sufficient to form a belief as to the truth of an allegation, it shall so state.

Upon receipt of a written notice requesting a hearing, this matter will be scheduled for a hearing. Respondent may then appear, with or without the assistance of an attorney, at the hearing to present testimony, evidence, and argument relating to the matters contained herein. In

the event a written notice requesting a hearing is not received within the above-stated thirty (30) day period of time, an Order Suspending Respondent's Registration and Imposing an Administrative Fine may be entered in this proceeding with no further notice.

By seeking an Order Suspending Respondent's Registration and Imposing an Administrative Fine, the Division is not waiving any rights it may have to pursue additional remedies available to it for the above or other violations of the Act committed by Morgan Stanley or Respondent.

Executed and entered, this the 6th day of January, 2011.

SOUTH CAROLINA OFFICE OF

THE ATTORNEY GENERAL

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