

**STATE OF ILLINOIS
SECRETARY OF STATE
SECURITIES DEPARTMENT**

In the matter of)
)
MORGAN STANLEY & CO.)
INCORPORATED (CRD# 8209),) File #: 08-00237
)
Respondent.)
)
)

NOTICE OF HEARING

TO THE RESPONDENT: Morgan Stanley & Co, Inc. (CRD # 8209)
C/O S. Anthony Taggart
1585 Broadway
New York, NY 10036-8293

You are hereby notified that, pursuant to Section 11.F of the Illinois Securities Law of 1953 [815 ILCS 5] (the "Act") and 14 Ill. Adm. Code 130, Subpart K (the "Rules"), a public hearing will be held at 69 West Washington Street, Suite 1220, Chicago, Illinois 60602, on the 1st day of December , 2009, at the hour of 10:00 a.m., or as soon thereafter as counsel may be heard, before George P. Berbas, or another duly designated Hearing Officer of the Secretary of State.

This hearing will be held to determine whether an Order shall be entered against the Respondent in the State of Illinois and/or grant such other relief as may be authorized under the Act including but not limited to imposition of a monetary fine in the maximum amount pursuant to Section 11.E(4) of the Act, payable within ten (10) business days of the entry of the Order.

The grounds for such proposed action are as follows:

Unethical Practices in the Offer and Sale of Auction Rate Securities

1. Auction rate securities are financial instruments that include auction preferred shares of closed-end funds, municipal auction rate bonds, and various asset-backed auction rate bonds (collectively referred to herein as "ARS"). ARS are long-term instruments where the interest/dividend is reset weekly or monthly.
2. Morgan Stanley participated in the marketing and sale of ARS.
3. In certain instances, Morgan Stanley, through its salespeople, advised certain clients that ARS were safe, liquid investments, when in fact auction rate securities had significant liquidity risks associated with them.
4. Representatives of Morgan Stanley represented to certain customers of Morgan Stanley that ARS were short-term investments. In fact, because ARS are bonds with long-term maturities, their short-term liquidity was dependent on the successful operation of a bidding process known as a Dutch auction. Certain representatives of Morgan Stanley failed to disclose to certain customers with short-term liquidity needs that they might be unable to sell their ARS if the auction process failed.
5. In connection with the sale of ARS, certain Morgan Stanley sales people told certain investors that ARS were "just like cash" and "liquid with seven days notice."
6. Morgan Stanley marketed ARS to investors within a brochure entitled "Money Market Instruments." Within this brochure, ARS are listed under the subsection "Other Short-Term Instruments."
7. Since it began participating in the auction rate securities market, Morgan Stanley submitted support bids-- purchase orders for the entirety of an auction rate

security issue for which it acted as the sole or lead broker. Support bids were Morgan Stanley proprietary orders that would be filled, in whole or in part, if there was otherwise insufficient demand in an auction. When Morgan Stanley purchased auction rate securities through support bids, auction rate securities were then owned by Morgan Stanley and the holdings were recorded on Morgan Stanley's balance sheet. For risk management purposes, Morgan Stanley imposed limits on the amounts of auction rate securities it could hold in inventory.

8. Because many investors could not ascertain how much of an auction was filled through Morgan Stanley proprietary trades, they could not determine if auctions at Morgan Stanley were clearing because of normal marketplace demand, or because Morgan Stanley was making up for the lack of demand through support bids. Generally, investors were also not aware that the liquidity of the auction rate securities as to which Morgan Stanley was the managing broker-dealer depended upon Morgan Stanley's continued use of support bids. While Morgan Stanley could track its own inventory as a measure of the supply and demand for its auction rate securities, ordinary investors had no comparable ability to assess the operation of Morgan Stanley's auctions. There was no way for such investors to monitor supply and demand in the market or to assess when broker-dealers might decide to stop supporting the market, thereby causing its collapse.
9. Starting in August 2007, the credit crisis and other deteriorating market conditions strained the auction rate securities market. Some institutional investors withdrew from the market, decreasing demand for auction rate securities.

10. The resulting market dislocation should have been evident to Morgan Stanley. Morgan Stanley's support bids filled the increasing gap in the demand in its auctions for auction rate securities, sustaining the impression that the demand for auction rate securities had not decreased. As a result, Morgan Stanley's auction rate securities inventory grew significantly, requiring Morgan Stanley to raise its risk management limits on its auction rate securities inventory.
11. From the Fall of 2007 through February of 2008, demand for auction rate securities continued to erode and Morgan Stanley's auction rate securities inventory reached unprecedented levels. Morgan Stanley eventually became aware of the increasing strains in the auction rate securities market, and recognized the potential for widespread market failure. Morgan Stanley never disclosed these increasing risks of owning or purchasing auction rate securities to its customers.
12. 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 or perpetual securities that could not be sold at par value until and if the auctions cleared again.

Failure to Supervise

13. Although ARS are complex products, Morgan Stanley did not provide its sales or marketing staff with the training necessary to adequately explain these products or the mechanics of the auction process to their customers.

14. **Morgan Stanley did not adequately train all of its brokers and financial advisers regarding the potential illiquidity of ARS, including the fact that Morgan Stanley may stop supporting the market.**

ALLEGATIONS OF LAW

15. **Illinois has jurisdiction over this matter pursuant to the Illinois Securities Law of 1953 [815 ILCS 5] (the "Act").**
16. **Morgan Stanley employed unethical practices in the offer and sale of auction rate securities, subjecting Morgan Stanley to sanctions under 8E.(1)(b) of the Act.**
17. **Morgan Stanley failed to reasonably supervise its agents or employees, in violation of Section 8.E(1)(c)(iv) of the Act.**

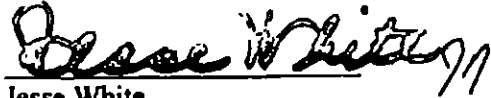
You are further notified that you are required pursuant to Section 130.1104 of the Rules and Regulations (14 Ill. Adm. Code 130)(the "Rules"), to file an answer, special appearance, or other responsive pleadings to the allegations above within thirty (30) days of the receipt of this Notice. A failure to file an answer within the prescribed time shall be construed as an admission of the allegations contained in the Notice of Hearing.

Furthermore, you may be represented by legal counsel; may present evidence; may cross-examine witnesses and otherwise participate. A failure to appear shall constitute a default by you.

A copy of the Rules and Regulations promulgated under the Illinois Securities Law and pertaining to hearings held by the Office of the Secretary of State, Illinois Securities Department, are available at <http://www.ilga.gov/commission/jcar/admincode/014/01400130sections.html>, or upon request

Delivery of Notice to the designated representative of the Respondent constitutes service upon such Respondent.

Dated: This 17th day of September, 2009.

A handwritten signature in black ink, appearing to read "Jesse White", with a horizontal line drawn underneath it.

**Jesse White
Secretary of State
State of Illinois**

Attorney for the Secretary of State:

**Angela P. Angelakos
Office of the Secretary of State
Illinois Securities Department
69 West Washington, Suite 1220
Chicago, Illinois 60602
(312) 793-3595**

Hearing Officer:

**George P. Berbas
180 N. LaSalle St., Suite 2105
Chicago, IL 60601**