STATE OF NEW JERSEY
BUREAU OF SECURITIES
P.O. Box 47029
Newark, New Jersey 07101
Telephone (973) 504-3600

IN THE MATTER OF:

Morgan Stanley & Co. LLC
(CRD# 8209)

CONSENT ORDER

Pursuant to the authority granted to Abbe R. Tiger, Chief of the New Jersey Bureau of Securities ("Bureau Chief), under the Uniform Securities Law (1997), N.J.S.A. 49:3-47 et seq. ("Securities Law"), and after investigation, review, and due consideration of the facts and statutory provisions set forth below, the Bureau Chief has determined that civil monetary penalties and additional monetary remedies be assessed against Morgan Stanley & Co. LLC ("MSCO").[1]

WHEREAS, the New Jersey Bureau of Securities (the "Bureau") is the State agency with the responsibility to administer and enforce the Securities Law; and

WHEREAS, N.J.S.A. 49:3-67 authorizes the Bureau Chief from time to time to issue such Orders as are necessary to carry out the provisions of the Securities Law, upon a finding that the action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes fairly intended by the provisions of the Securities Law; and

[1] Effective June 1, 2009, MSCO's Global Wealth Management Group combined with the Smith Barney Division of Citigroup Global Markets, Inc. to become Morgan Stanley Smith Barney Holdings LLC, a new joint venture that directly owns Morgan Stanley Smith Barney LLC. As of June 2011, Morgan Stanley & Co. Incorporated converted to a limited liability company and changed its name to Morgan Stanley & Co. LLC. The conduct described herein occurred almost entirely at MSCO.

WHEREAS, the Bureau has conducted an investigation that began in 2011 into MSCO's sales and supervisory practices with respect to leveraged, inverse, and inverse-leveraged Exchange-Traded Funds ("Non-Traditional ETFs") during the period of January 2007 through June 2009 (the "Relevant Period"); and

WHEREAS, MSCO and the Bureau Chief wish to resolve these issues without the expense and delay that formal administrative proceedings would involve; and

WHEREAS, the Bureau Chief has found that entry of this Consent Order is appropriate in the public interest and consistent with the purposes fairly intended by the policy and provisions of the Securities Law and regulations promulgated thereunder; and

WHEREAS, MSCO consents to the form and entry of this Consent Order. Accordingly, MSCO waives the following rights:

a. To be afforded an opportunity for hearing on the Bureau Chiefs findings and conclusions of law in this Consent Order after reasonable notice within the meaning of N.J.S.A. 49:3-58(c)(2); and

b. To seek judicial review of, or otherwise challenge or contend, the validity of this Consent Order; and

WHEREAS, MSCO agrees that solely for the purpose of settling this matter, or any future proceedings by the Bureau that this Consent Order shall have the same effect as if proven and ordered after a full hearing held pursuant to N.J.S.A. 52:14B-1 et seq.; and

WHEREAS, this Consent Order concludes the investigation and action by the Bureau Chief and any civil or administrative action that could be commenced, pursuant to the Securities Law, on behalf of the Bureau Chief, as it relates to seeking civil monetary penalties or other relief against MSCO for the conduct described herein.

FINDINGS OF FACT

The Bureau Chief makes the following findings of fact, which MSCO neither admits nor denies:

1. MSCO (CRD# 8209) is a registered broker-dealer with its home office at 1585 Broadway, New York, New York, 10036.

2. In or about June 2006, MSCO began offering Non-Traditional ETFs to its customers.

Background Information on Non-Traditional ETFs

3. Exchange-Traded Funds ("ETFs") are typically registered unit investment trusts or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index. Shares of ETFs are generally traded throughout the day on a national securities exchange at prices established by the market.

4. ETFs were first introduced in 1989 and have since proliferated, tailored to an increasingly specific array of regions, sectors, commodities, bonds, futures, and other asset classes. By the end of 2011, the total number of index-based and actively managed ETFs had grown to 1,134, with total net assets of $1,048 billion.

5. The growth in Non-Traditional ETFs, which were introduced in June 2006, has followed a similar trajectory. By April 2009, over 100 Non-Traditional ETFs were available in the marketplace, with total assets under management of approximately $22 billion.

6. Non-Traditional ETFs are comprised of three sub-types.

    a. Leveraged ETFs are designed to deliver multiples of the performance (usually 2x or 3x) of the index or benchmark they track.

    b. Inverse-leveraged ETFs are designed to deliver multiples of the opposite of the performance (usually -2x or -3x) of the index or benchmark they track.

    c. Inverse ETFs are designed to deliver the opposite of the performance (-1x) of the index or benchmark they track.

7. Non-Traditional ETFs accomplish their objectives by utilizing a range of investment strategies, such as swaps, futures contracts, and other derivative instruments.

8. Most Non-Traditional ETFs "reset" daily, meaning that the value of a Non-Traditional ETF is adjusted daily in order to maintain the proportional exposure to the index or benchmark it is designed to track. Due to the effects of this daily "reset", Non-Traditional ETFs are intended to achieve their stated objectives only on a daily basis. When held for periods longer than a single day, Non-Traditional ETFs can begin to generate returns that differ significantly from the performance of the underlying indices or benchmarks that they are designed to track.

9. This increased possibility of "tracking error" is due to several factors, including the interest costs of leveraging, interest credits, the effects of compounding, and internal expense ratios.

10. Tracking error in Non-Traditional ETFs is particularly evident in volatile markets due to the magnified effects of compounding. When held for periods longer than a single day, the volatility present in the index or benchmark that the Non-Traditional ETF tracks can affect the returns generated by the Non-Traditional ETF, even when the index or sector moves in the general direction that the purchaser predicted or expected. The greater the volatility in the market during a particular period, the greater the likelihood that a particular Non-Traditional ETF will produce an extreme and unpredictable result – thereby increasing the risk associated with that product.

11. The heightened market volatility during much of 2008 and 2009 serves to illustrate this point. By way of example, between December 1, 2008 and April 30, 2009, the Dow Jones U.S. Oil & Gas Index gained two percent, while an ETF seeking to deliver twice the daily return of

the index (ticker symbol DIG) fell six percent, and the related ETF seeking to deliver twice the inverse of the daily return of the index (ticker symbol DUG) fell 26 percent.

FINRA Regulatory Notice Regarding Non-Traditional ETFs

12. The Financial Industry Regulatory Authority ("FINRA") released Regulatory Notice 09-31 in June 2009 ("June 2009 FINRA Notice"), reminding member firms of their sales and supervisory practice obligations in connection with Non-Traditional ETFs.

13. The June 2009 FINRA Notice described Non-Traditional ETFs as "highly complex financial instruments that are typically designed to achieve their stated objectives on a daily basis."

14. The June 2009 FINRA Notice concluded that "due to the effects of compounding, [Non-Traditional ETF] performance over longer periods of time can differ significantly from their stated daily objective," and that "therefore, inverse and leveraged ETFs that reset daily typically are unsuitable for retail investors who plan to hold them for longer than one trading session, particularly in volatile markets."

MSCO Failed to Provide Adequate Training on Non-Traditional ETFs

15. MSCO failed to provide adequate formal training to financial advisors ("FAs") regarding the unique features, risks, and characteristics of Non-Traditional ETFs.

16. Limited general ETF training was conducted at least monthly, often at MSCO's headquarters in Purchase, New York or in New York City. These training sessions were for the purpose of explaining the broad ETF product category to new FAs and those transitioning to more discretionary business. During the Relevant Period, these training sessions generally included a discussion of Non-Traditional ETFs.

17. Certain MSCO FAs who sold Non-Traditional ETFs, and their supervisors, did not receive training or notices to review training documents with respect to Non-Traditional ETFs, until after the June 2009 FINRA Notice.

MSCO Failed to Implement a Reasonable System for the Supervision of the Sale of Non-Traditional ETFs

18. MSCO failed to establish a reasonable supervisory system and written supervisory procedures concerning sales of Non-Traditional ETFs by its FAs during the Relevant Period.

19. MSCO made no distinction between Non-Traditional ETFs and other more traditional ETFs for supervisory and sales purposes during the Relevant Period.

20. Although MSCO maintained a sophisticated system of trade reports, exception reports, and alerts designed to attract the attention of supervisors and compliance persons, there were no Non-Traditional ETF-specific criteria for triggering these reports.

21. MSCO's supervisory and compliance manuals during the Relevant Period contained no specific guidelines or cautionary instructions regarding Non-Traditional ETFs. The manuals did not make any reference to Non-Traditional ETF products.

22. After the June 2009 FINRA Notice, MSCO immediately took several steps to remedy their deficient supervisory systems, in particular prohibiting the purchase of leveraged and inverse-leveraged Non-Traditional ETFs in advisory accounts and the solicited purchase of Non-Traditional ETFs in brokerage accounts.

23. After the June 2009 FINRA Notice, MSCO also implemented system blocks to prevent prohibited purchases and made additional material available for FAs, including frequently asked questions, talking points for FAs in communication with clients, and talking points for supervisors in communication with FAs at MSCO.

MSCO Financial Advisors Solicited Unsuitable Purchases of Non-Traditional ETFs

24. Despite the risks associated with holding Non-Traditional ETFs for longer time periods, certain MSCO FAs solicited transactions that resulted in their customers holding Non-Traditional ETFs for extended time periods during the Relevant Period.

25. Several unsuitable Non-Traditional ETF transactions solicited by MSCO agents involved New Jersey-based customers. For example:

a. An 89-year old customer residing in New Jersey with a primary investment objective of income and a net worth of $200,000 allocated 59% of the account to a single Non-Traditional ETF that was purchased on a solicited basis and held for nearly two months, sustaining losses of over $10,000.

b. An 82-year old customer residing in New Jersey with a primary investment objective of income and a net worth of $1 million allocated 35% of the account to a single Non-Traditional ETF that was purchased on a solicited basis and held for over four months, sustaining losses just under $9,000.

Conclusions of Law

Solely for the purpose of this Consent Order, and without admitting or denying the findings of fact and conclusions of law, MSCO consents to the Bureau Chief making the following conclusions of law:

26. MSCO's conduct described above constitutes a failure to reasonably supervise in the securities business, pursuant to N.J.S.A. 49:3-58(a)(2)(xi).

27. MSCO's conduct described above constitutes dishonest and unethical conduct in the securities business, pursuant to N.J.S.A. 49:3-58(a)(2)(vii) and including N.J.A.C. 13:47A-6.3(a)(3).

THEREFORE, it is on this 29TH **day of July 2013**, HEREBY,

ORDERED and AGREED that:

28. This Consent Order concludes the investigation by the Bureau and any other action that the Bureau could commence under applicable New Jersey law on behalf of New Jersey as it relates to MSCO's sales and supervisory practices with respect to Non-Traditional ETFs during the period from January 2007 to June 2009.

29. This Consent Order is entered into solely for the purpose of resolving the investigation into MSCO's sales and supervisory practices with respect to Non-Traditional ETFs, and is not intended to be used for any other purpose.

30. This Consent Order shall be binding upon MSCO and its successors and assigns as well as to successors and assigns of relevant affiliates with respect to all conduct subject to the provisions above and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions, events, and conditions.

31. MSCO is assessed a civil monetary penalty in the amount of sixty-five thousand dollars($65,000.00) and costs in the amount of twenty-five thousand dollars ($25,000.000). Additionally, MSCO shall pay ten thousand dollars ($10,000.00) which shall be placed in a fund to be used for the Bureau's investor education program. The penalty, costs and investor education funds are due and payable by check or wire transfer within ten days of the entry of this Consent Order to "State of New Jersey, Bureau of Securities," 153 Halsey Street, 6th Floor, Newark, New Jersey 07102, or to be received at "Bureau of Securities," P.O. Box 47029, Newark, New Jersey 07101. The civil monetary penalty and costs payment shall be deposited in the Securities Enforcement Fund, pursuant to <u>N.J.S.A.</u> 49:3-66.1.

32. MSCO paid restitution in the amount of $96,940.34 to New Jersey customers.

33. This Consent Order shall be deemed the final decision as to MSCO pursuant to N.J.A.C. 1:1-19.1(d).

34. Nothing in this Consent Order is intended to limit or supersede any authority or remedy available to the Bureau Chief under the Securities Law.

35. No employee or official of, or person representing, the Bureau or the State of New Jersey has made any additional promise or representation to MSCO regarding this Consent Order.

36. MSCO agrees that solely for the purpose of this matter or future proceedings to enforce this Consent Order that this Consent Order shall have the same effect as if proven and ordered after a full hearing pursuant to N.J.S.A. 52:14B-1 et seq.

NEW JERSEY BUREAU OF SECURITIES

By: ______________________
Abbe R. Tiger, Chief

DATED:

MORGAN STANLEY & CO. LLC

By: ______________________
Scott Tucker

Title: Global Head of Litigation