

**Disciplinary Panel
American Stock Exchange LLC**

IN THE MATTER
OF
MORGAN STANLEY DW, INC.

Case No. 06-209
Hearing Officer – RSH

DECISION
October 10, 2006

In accordance with a Stipulation of Facts and Consent to Penalty, the Disciplinary Panel Chair determined that Respondent violated AMEX Rule 30 and AMEX Rule 320(b), as stipulated, and as a penalty imposed a censure, a \$500,000 fine to be paid jointly to NASD, the NYSE, and the Exchange, and an undertaking that the Firm revise its written supervisory procedures.

I. Introduction

The American Stock Exchange, LLC (“Exchange”) instituted a formal disciplinary proceeding against Morgan Stanley DW, Incorporated (“Morgan Stanley” or the “Firm”), a Regular Member Organization of the Exchange. The Disciplinary Panel Chair (“Chair”), presiding without convening a full Disciplinary Panel, pursuant to Article V, Section 1(b) of the Exchange Constitution, held a hearing on September 6, 2006, pursuant to Article V, Section 2 of the Exchange Constitution, to review a Stipulation of Facts and Consent to Penalty (“Stipulation”), which is attached as Exhibit A. The Firm did not participate in the hearing.

The Exchange and Morgan Stanley entered into the Stipulation for the purposes of settling this proceeding and concluding all disciplinary actions by the Exchange against Morgan Stanley based upon or arising out of the facts set forth in the Stipulation.

III. Violations

Based upon the stipulated facts, the Chair concludes that Morgan Stanley:

(1) violated Exchange Rule 30 by failing to report short interest positions or by submitting inaccurate short interest reports in preferred securities and affiliates' securities "for an unknown, but significant number of years until the Firm corrected the problem in February 2006." These violations occurred in reports to the AMEX, NYSE and NASD; and

(2) violated Exchange Rule 320 by failing to have adequate procedures in place for the calculation and reporting of mid-month and end-of-month short interest to the AMEX and by failing to have a supervisory system which included written supervisory procedures providing for: (i) identification of the person(s) responsible for supervision with respect to the applicable rule; (ii) a statement of the supervisory step(s) to be taken by the identified person(s); (iii) a statement as to how often such person(s) should take such step(s); and (iv) a statement as to how the completion of the step(s) included in the written supervisory procedures should be documented.

IV. Penalties and Publicity

The Stipulation proposes that the Disciplinary Panel Chair impose on Morgan Stanley a censure, a \$500,000 fine to be paid jointly to NASD, the NYSE and the Exchange, and an undertaking for the Firm to revise its written supervisory procedures as described in the Disciplinary Action section of the Stipulation.

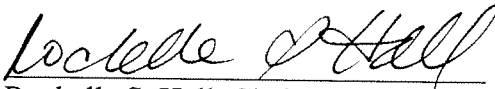
At the hearing, the Exchange urged the Disciplinary Panel Chair to approve the proposed penalty. After considering the Stipulation, as well as the decisions cited in the Exchange's precedent memorandum, and the fact that this is a joint settlement with the NYSE and NASD, the Chair finds that the proposed penalties are appropriate under the facts and circumstances of this case. Therefore, the Chair approves the Stipulation of Facts and Consent to Penalty.

The Chair further finds that the results of this disciplinary proceeding should be publicly disclosed, as provided in Rule 12 of the Exchange Rules on Disciplinary Proceedings.¹

V. Conclusion

The Disciplinary Panel Chair accepts the Stipulation of Facts and Consent to Penalty and hereby imposes upon Morgan Stanley, DW, Inc., a censure, a \$500,000 fine to be paid jointly to NASD, the NYSE and the Exchange, and a requirement that the Firm revise its written supervisory procedures.

FOR THE DISCIPLINARY PANEL

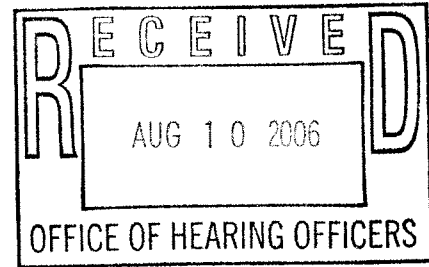

Rochelle S. Hall, Chair

Copies to: Riche McKnight, Esq. (*via facsimile and first class mail*)
Morgan Stanley DW, Inc. (*via overnight and first class mail*)
Sebastian Krawczyk, Esq. (*electronically and via first class mail*)
Arlene Collins-Day (*electronically and via first class mail*)

¹ Rule 12 exempts from publicity those cases in which the Panel finds that the offense “related solely to minor administrative requirements of the Exchange and does not materially affect the public interest or the interest of investors.” That exemption does not apply to the facts of this case.

EXHIBIT A

**Disciplinary Panel
American Stock Exchange LLC**



IN THE MATTER
OF
MORGAN STANLEY DW, INC.

**STIPULATION OF FACTS AND
CONSENT TO PENALTY**
Case No. 06-209

This proceeding was instituted by the American Stock Exchange LLC (“AMEX”) against MORGAN STANLEY DW, INC. (the “Firm”) (CRD No. 7556), a Regular Member Organization of the Exchange. This Stipulation of Facts and Consent to Penalty (“Stipulation”) is entered into with the Firm pursuant to Article V, Section 2 of the AMEX Constitution in order to settle and conclude all disciplinary actions by the AMEX against the Firm based upon or arising out of the facts hereinafter stipulated. The Firm, without admitting or denying the facts, allegations and conclusions contained in this Stipulation, hereby consents to the entry of findings of violations of AMEX Rules and the imposition of the penalties hereinafter provided. The Firm understands that this settlement is subject to approval by an AMEX Disciplinary Panel and by the AMEX Adjudicatory Council and that, if so approved, shall constitute a final decision, which may not be appealed by the parties. The Firm understands and acknowledges that the Disciplinary Panel’s decision in this matter will become part of its disciplinary record and may be considered in any future proceeding brought by the AMEX.

STIPULATED FACTS:

- 1.0 During all relevant periods herein, the Firm was a member organization of the AMEX, NASD, and the New York Stock Exchange Inc. (the “NYSE”) (collectively referred to as the “SROs”).
- 1.1 During all relevant periods herein, the Firm maintained its headquarters in New York and provided a full range of investment services to both individual and institutional investors.
- 1.2 During all relevant periods herein, the Firm was subject to AMEX Rule 30, which requires that members and member organizations file with the AMEX such periodic reports or special reports as the Board of Governors may, by rule, or otherwise, from time to time authorize.
- 1.3 AMEX Information Circular No. 95-136 (“Reporting of Monthly Short Interest Positions”), distributed May 8, 1995, advised all members and member organizations that it was their responsibility to report to the AMEX, the relevant short positions in AMEX-listed securities maintained by them, certain subsidiaries and their customers pursuant to AMEX Rule 30. Short positions in AMEX-listed securities were required to be reported on the 15th of each month, or where the 15th was a non-settlement date, on the preceding settlement date.
- 1.4 AMEX Information Circular No. 98-0234 (“Additional Short Position Reporting of AMEX-Listed Securities”), distributed February 26, 1998, advised all members and member organizations that it was their responsibility to report to the AMEX, the relevant short positions in AMEX-listed Diamonds, SPDRS, MIDCAP SPDRS and the various WEBS series maintained by them, certain subsidiaries,

and their customers pursuant to AMEX Rule 30. Commencing with the April 30, 1998 settlement date, in addition to the mid-month reporting described in paragraph 1.3 above, short positions in the aforementioned derivative securities were also required to be reported as of the close of the settlement date falling on the last business day of each month.

- 1.5 During all relevant periods herein, the aggregate short interest positions at the AMEX, NASD and the NYSE were disseminated to the public through the various SROs and financial publications on the basis of individual short interest reports sent to the SROs by individual firms.

Inaccurate Reporting of Short Interest Positions

- 2.0 In or about August 2005, NASD staff made a routine inquiry to the Firm requesting that the Firm verify the accuracy of the Firm's short interest position for an equity security listed on The Nasdaq Stock Market ("Nasdaq"). As a result of this inquiry, the Firm discovered a systemic issue affecting the Firm's short interest reporting program that resulted in the filing of inaccurate short interest reports with each SRO for years.
- 2.1 The software program responsible for generating the Firm's short interest reports utilized a "z indicator" to code equity securities that traded on multiple exchanges or markets. The short interest software program would code a security with a z indicator when the security traded on an exchange or market other than the security's primary exchange or market. The Firm's short interest software program excluded any short positions in equity securities that had been coded

with a z indicator on the settlement date that the Firm prepared its monthly short interest position reports for submission to the SROs.

- 2.2 The Firm had been utilizing the z indicator since 1972 for Nasdaq-listed securities. The NASD's short interest reporting rule went into effect in February 1986. The Firm did not begin using the z indicator for AMEX and NYSE-listed securities until August 2004.
- 2.3 The Firm's use of the z indicator caused the Firm to submit inaccurate mid-month and end-of-month short interest position reports to the AMEX during the period August 2004 through October 2005.
- 2.4 Based upon a review of a seven-month sample of short interest reports from March 2005 through September 2005, the Firm failed to report mid-month short interest positions in AMEX-listed securities coded with the z indicator on approximately 44 occasions for short interest positions totaling approximately 449,274 shares. All but one of the short interest positions not reported constituted less than 1% of the total short interest reported by the overall market.
- 2.5 Based upon a review of a seven-month sample of short interest reports from March 2005 through September 2005, the Firm failed to report end-of-month short interest positions in AMEX-listed securities coded with the z indicator on approximately 43 occasions for short interest positions totaling approximately 693,397 shares. All of the short interest positions not reported constituted less than 1% of the total short interest reported by the overall market.
- 2.6 For one month tested, June 2005, the Firm failed to report short positions in 11 NYSE-listed securities, seven AMEX-listed securities, and 137 Nasdaq-listed

securities. The percentage of short positions that the Firm failed to report as compared to the positions reported by the overall market was small. Most of the positions not reported by the Firm constituted less than 1% of the positions reported by the overall market.

- 2.7 The Firm discovered the cause of the short interest reporting problem in September 2005 and suspended the use of the z indicator in November 2005. During the course of the investigation by the SROs, the Firm discovered a separate issue that affected the Firm's short interest reports to the SROs regarding preferred securities and securities issued by affiliates – for example, the Firm's parent company's publicly traded shares and publicly traded investment funds.
- 2.8 The software program responsible for generating the Firm's short interest reports utilized a filter that excluded short positions in preferred securities and affiliates' securities from the monthly short interest reports submitted to the SROs. The Firm implemented the software filter causing short positions in preferred securities and affiliates' securities to be excluded from its reports because the Firm held the inaccurate belief that it was not required to report such short positions to the SROs. The Firm believes that the software filter has been in place for an unknown, but significant number of years.
- 2.9 The Firm's use of the software filter caused the Firm to submit inaccurate short interest reports in preferred securities and affiliates' securities to the AMEX, NYSE and NASD for an unknown, but significant number of years until the Firm corrected the problem in February 2006.

- 2.10 Based upon a review of a seven-month sample of short interest reports from June 2005 through December 2005, the Firm failed to report short interest positions in preferred securities to the AMEX on approximately 20 occasions, for short interest positions totaling approximately 15,650 shares.

Supervisory Deficiencies

- 3.0 During all relevant periods herein, the Firm was subject to AMEX Rule 320(b) which provided that:
- “Each office, department or business activity of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility. The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer including compliance with securities laws and regulations.”
- 3.1 During all relevant periods herein, the Firm relied on an automated system to comply with its short interest reporting requirements. The automated system utilized a program that excluded short interest for preferred securities, affiliates’ securities and securities coded with a z indicator. There was no procedure to ensure the accuracy of the reports submitted to the SROs.
- 3.2 The Firm failed to adequately supervise its process for reporting short interest to the AMEX because it failed to detect inaccuracies associated with its short

position reports and failed to have an adequate system of follow-up and review for compliance with AMEX rules with respect to short interest reporting.

- 3.3 The Firm's supervisory system did not have adequate procedures in place regarding the calculation and reporting of mid-month and end-of-month short interest to the AMEX and the Firm's supervisory system did not include written supervisory procedures providing for: (1) the identification of the person(s) responsible for supervision with respect to the applicable rule; (2) a statement of the supervisory step(s) to be taken by the identified person(s); (3) a statement as to how often such person(s) should take such step(s); and (4) a statement as to how the completion of the step(s) included in the written supervisory procedures should be documented.

CONCLUSION:

By reason of the foregoing Stipulated Facts, a Disciplinary Panel may conclude that:

- 4.0 The Firm violated AMEX Rule 30 in that the Firm submitted inaccurate reports of short interest positions to the AMEX, as set forth in paragraphs 2.0 through 2.10.
- 4.1 The Firm violated AMEX Rule 320 in that the firm failed to establish and maintain appropriate policies, systems and procedures of supervision and control, including written supervisory procedures, and failed to establish a separate system of follow-up and review to ensure compliance with short interest reporting requirements of the AMEX, as set forth in above paragraphs 3.0 through 3.3.

DISCIPLINARY ACTION:

By reason of the foregoing Stipulated Facts, a Disciplinary Panel may impose the following penalties upon the Firm:

- (a) a censure;
- (b) a fine in the amount of \$500,000 to be paid jointly to the AMEX, the NYSE and NASD; and
- (c) an undertaking for the Firm to revise its written supervisory procedures with respect to the areas described in paragraph 3.3. Within 60 business days of acceptance of this Stipulation by an AMEX Hearing Panel, a registered principal of the Firm shall submit to the COMPLIANCE ASSISTANT, NASD AMEX REGULATION DIVISION, ENFORCEMENT DEPARTMENT, ONE LIBERTY PLAZA, NEW YORK, NY 10006, a signed, dated letter, providing the following information: (1) a reference to this matter; (2) a representation that the Firm has revised its written supervisory procedures to address the deficiencies described in paragraph 3.3; and, (3) the date the revised procedures were implemented.

The Firm hereby acknowledges that it has read carefully this Stipulation and understands all of the provisions contained herein; that the Firm has agreed to its provisions voluntarily; and that no offer, promise, threat or inducement of any kind has been tendered to the Firm by the AMEX, its staff or representatives to induce the Firm to enter into this Stipulation, aside from the prospect of settling this disciplinary proceeding based on the terms and conditions set forth in this Stipulation rather than adjudicating this matter by way of a hearing on a Charge Memorandum as provided by AMEX Rules.

Further, the Firm hereby agrees that it may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this Stipulation or create the impression that the Stipulation is

without factual basis. Nothing in this provision affects the Firm's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which the Exchange is not a party.

Finally, it is understood and agreed that in any written submission to or proceeding before any person or body convened to consider this Stipulation (including, but not limited to, a Hearing Officer acting alone, a Hearing Panel, or any reviewing body authorized by the AMEX Constitution and/or Rules), neither Enforcement nor the Firm shall offer any argument that is inconsistent with the stipulated facts or the agreed-upon penalty, nor shall either party ask for the imposition of any penalty other than that agreed upon in this Stipulation.

AMERICAN STOCK EXCHANGE LLC

By: _____
David Rosenstein
Vice President and Chief Counsel
NASD Amex Regulation Division

MORGAN STANLEY DW, INC.

By: _____

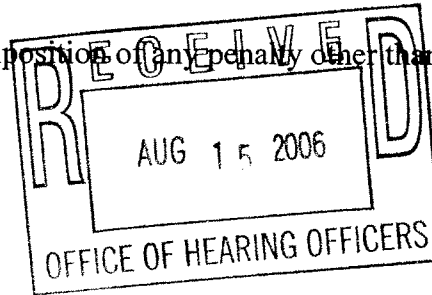
Name: NOLAND CHENG

Title: MANAGING DIRECTOR

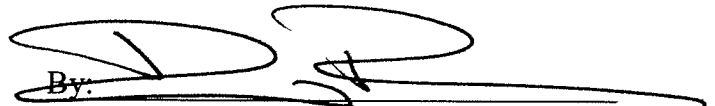
Agreed to this 1ST day of AUGUST, 2006.

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AMERICAN STOCK EXCHANGE LLC

By: 

David Rosenstein
Vice President and Chief Counsel
NASD Amex Regulation Division

MORGAN STANLEY DW, INC.

By: _____

Name: _____

Title: _____

Agreed to this _____ day of _____, 2006.