

Morgan Stanley to Pay \$275 Million for Misleading Investors in Subprime RMBS Offerings

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Washington D.C., July 24, 2014 — The Securities and Exchange Commission today charged three Morgan Stanley entities with misleading investors in a pair of residential mortgage-backed securities (RMBS) securitizations that the firms underwrote, sponsored, and issued.

Morgan Stanley agreed to settle the charges by paying \$275 million to be returned to harmed investors.

In an asset-backed securities offering, federal regulations under the securities laws require the disclosure of delinquency information for the mortgage loans serving as collateral. An SEC investigation found that Morgan Stanley misrepresented the current or historical delinquency status of mortgage loans underlying two subprime RMBS securitizations that came against a backdrop of rising borrower delinquencies and unprecedented distress in the subprime market.

"The delinquency status of mortgage loans in an RMBS securitization is vital information to investors because those loans are the primary source of funds by which they potentially can recover and profit from their investments," said Michael Osnato, chief of the SEC Enforcement Division's Complex Financial Instruments Unit. "Morgan Stanley understated the number of delinquent loans behind these securitizations during a critical juncture of the financial crisis and denied investors the full extent of the facts necessary to make informed investment decisions."

According to the SEC's order instituting a settled administrative proceeding against Morgan Stanley & Co. LLC, Morgan Stanley ABS Capital I Inc., and Morgan Stanley Mortgage Capital Holdings LLC, these securitizations were collateralized by mortgage loans with an aggregate principal value balance of more than \$2.5 billion. They were the last subprime RMBS that Morgan Stanley sponsored, issued, and underwrote. The offerings themselves were called Morgan Stanley ABS Capital I Inc. Trust 2007-NC4 and Morgan Capital I Inc. Trust 2007-HE7.

The SEC's order finds that offering documents for the securitizations stated that less than 1 percent of each pool's aggregate principal balance was more than 30 days but less than 60 days delinquent as of each securitization's cut-off date. With the exception of these loans, Morgan Stanley represented as of each securitization's closing date that no payment under any mortgage loan was more than 30 days delinquent at any time since origination. On the contrary, approximately 17 percent of the loans in the HE7 securitization had been delinquent at some point since origination, and in the NC4 securitization approximately 4.5 percent of the loans were currently delinquent rather than the disclosed 1 percent.

According to the SEC's order, for the HE7 securitization, Morgan Stanley had a chart showing that approximately 17 percent of the loans had been delinquent at some point since origination, and Morgan Stanley also used information about payments made after the cut-off date to determine the loans disclosed as delinquent as of the cut-off date. By using the later payment data, Morgan Stanley misreported 46 fewer loans as currently delinquent, leading the firm to disclose that less than 1 percent of the loans were delinquent. The NC4 securitization did not close until the month after the cut-off date, so Morgan Stanley received updated payment information at that time. This information showed that approximately 4.5 percent of the loans had become delinquent. Yet despite the delayed closing and a representation that extended the delinquency representation to the closing, Morgan Stanley did not disclose or remove the additional delinquent loans and instead continued with the 1 percent figure.

The SEC charged Morgan Stanley with violations of Sections 17(a)(2) and (3) of the Securities Act of 1933. Without admitting or denying the allegations, the firm agreed to the entry of an order that requires a payment of \$160,627,852 in disgorgement, \$17,995,437 in prejudgment interest, and a \$96,376,711 penalty. The order notes that a Fair Fund is being created for the disgorgement, interest, and penalties paid in this case for the purpose of returning money to investors who were harmed in these securitizations.

The SEC's investigation was conducted by Andrew Sporkin, Jeffrey Weiss, Creola Kelly, Melissa Lessenberry, and Delmer Raibourn in the Complex Financial Instruments Unit with assistance from Kyle DeYoung of the trial unit and Eugene Canjels in the Division of Economic and Risk Analysis. The SEC appreciates the assistance of the federal-state Residential Mortgage-Backed Securities Working Group.

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Related Materials

- [SEC order](#)