

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2010022049804**

**TO:** Department of Enforcement  
Financial Industry Regulatory Authority ("FINRA")

**RE:** Morgan Stanley & Co. LLC, Respondent  
Broker-Dealer  
CRD No. 8209

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Morgan Stanley & Co. LLC ("Morgan Stanley" or the "Firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Morgan Stanley alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. The Firm hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

**BACKGROUND**

Morgan Stanley is a full service brokerage firm headquartered in New York, New York and provides equity research, sales and trading services as well as underwriting services. The Firm is registered with the Municipal Securities Rulemaking Board ("MSRB").

**RELEVANT DISCIPLINARY HISTORY**

In connection with FINRA Matter No. 2006005603101, dated October 2011, without admitting or denying them, Morgan Stanley consented to findings that it violated FINRA Rule 2010, NASD Rules 2110, 2440, 3010, and IM-2440, and MSRB Rules G-17, G-30(a), and G-27, based on findings, among others, that the aggregate price, including markups and markdowns, at which the Firm engaged in certain corporate and municipal bond transactions with customers was not fair and

reasonable, and where the Firm's supervisory system for corporate and municipal bond markups and markdowns was not adequate. Morgan Stanley Smith Barney LLC consented to a censure and fine in the amount of \$1,000,000 and restitution in the amount of \$371,475.98. In addition, the Firm agreed to an undertaking to revise certain written supervisory procedures.

### **OVERVIEW**

Between January 2006 and October 2010 (the "Relevant Period"), Morgan Stanley violated fair dealing and supervisory rules of the MSRB by obtaining reimbursement for the voluntary payments that Morgan Stanley made to the California Public Securities Association ("Cal PSA"), on behalf of itself and other members of the underwriting syndicates, from the proceeds of municipal and state bond offerings.

During the Relevant Period, Morgan Stanley made payments to Cal PSA and requested that those payments be reimbursed as underwriting expenses from the proceeds of particular negotiated municipal and state bond offerings. This practice was unfair. Cal PSA's activities did not bear a direct relationship to those bond offerings, and were not expenses of conducting each underwriting. In addition, Morgan Stanley's requests for reimbursement were not fair because they were not accompanied by adequate disclosure to issuers about the nature of the fees. As discussed below, Cal PSA engaged in a variety of political activity.

Furthermore, Morgan Stanley failed to have adequate systems and written supervisory procedures reasonably designed to monitor the reimbursement process relating to expenses for municipal securities associations, including Cal PSA. In particular, Morgan Stanley's written supervisory procedures did not contain any policies requiring supervisors to review and approve Morgan Stanley's requests for reimbursement of those expenses to ensure that those requests were fair and adequate. In addition, Morgan Stanley failed to have adequate systems and written supervisory procedures reasonably designed to monitor how the municipal securities associations used the funds that Morgan Stanley paid. The need for adequate policies and procedures in this area was heightened in light of Cal PSA's engagement in a variety of political activities.

By virtue of the above conduct, Morgan Stanley violated MSRB Rules G-17 and G-27.

## **FACTS AND VIOLATIVE CONDUCT**

### **a) Factual Background**

Morgan Stanley was a member of certain municipal securities associations, including Cal PSA, throughout the Relevant Period. During the Relevant Period, most of Cal PSA's members were underwriters of bond issuances. There is no statutory or regulatory requirement that a firm join Cal PSA in order to underwrite a bond offering.

Cal PSA requested that its members make payments entitled "underwriting assessments." As a general practice, from on or about January 1, 2006 until on or about May 1, 2010, Cal PSA requested that its members pay underwriting assessments in the amount of \$0.01 per bond, when they participated in bond issuances in California of more than \$2 million in issue size and with more than two years to maturity. For example, if Morgan Stanley participated in a bond issuance in the amount of \$100 million, with a maturity date of more than two years, Cal PSA requested an underwriting assessment in the amount of \$1,000. After on or about May 1, 2010, Cal PSA requested underwriting assessments in the amount of \$0.02 per bond, when members participated in transactions of the same type. During the Relevant Period, Cal PSA capped its assessments at \$25,000 per bond issuance.

During the Relevant Period, Cal PSA's express mission was to keep its members informed of legislative and regulatory developments affecting the municipal securities industry and to provide a forum through which the municipal securities industry could review and respond to these developments. Cal PSA attempted to serve as the focal point for the public finance industry's relationship with California's legislature. In furtherance of its mission, Cal PSA controlled two political action committees, provided input into the drafting of legislation, and retained a political lobbyist that provided legislative advocacy or lobbying services for companies seeking to influence California state government.

Cal PSA billed its members on the per-bond basis described above, regardless of whether there was any direct relationship between that bond issuance and the association's activities, and regardless of whether the association provided any services required for the underwriting.

Morgan Stanley received an invoice from Cal PSA for underwriting assessments when it participated in the underwriting of approximately 149 applicable transactions. In connection with those invoices, Morgan Stanley paid Cal PSA a total of \$247,718 during the Relevant Period.

**b) Morgan Stanley Violated MSRB G-17 By Unfairly Requesting and Receiving Reimbursements for Cal PSA Underwriting Assessments**

MSRB Rule G-17 requires each municipal securities dealer and municipal advisor to deal fairly with all persons and not engage in any unfair practice.

Morgan Stanley's practice of obtaining reimbursement for the voluntary payments to Cal PSA from the proceeds of municipal and state bond offerings, as described above, was unfair.

First, these assessments did not bear a direct relationship to any activities conducted with respect to each bond offering. For example, Cal PSA's political activity was not necessary to perform any particular underwriting. In addition, Morgan Stanley was not required by any statute or regulation to be a member of Cal PSA in order to underwrite bond offerings. Yet Morgan Stanley treated its Cal PSA underwriting assessments as an expense of each transaction, and requested and received reimbursement of those payments from the proceeds of each bond offering.

Second, the Firm, on behalf of itself and the other members of the underwriting syndicate, listed the voluntary Cal PSA underwriting assessments as expenses of the underwriting, with other costs such as travel, printing and telephone costs. However, unlike these categories of expense payments, the underwriting assessments did not directly correspond with work performed or costs incurred to underwrite each bond offering, and were not necessary to conduct the offering. As a result, the Firm's requests for reimbursement were not fair because they were not accompanied by adequate disclosure to issuers about the nature of the fees.

Third, the Firm's above-described practices resulted in the expenditure of the proceeds of municipal and state bond offerings to an organization that engaged in political activities, including hiring a lobbyist to monitor political developments and advocating, from time to time, for various legislative action.

To date, in response to a request from the Treasurer of the State of California, Morgan Stanley has returned \$56,407.19 to multiple issuers, as a refund for the Cal PSA underwriting assessments that were reimbursed from offering proceeds.

**c) Morgan Stanley Violated MSRB Rule G-27 by Failing to Adopt, Maintain and Enforce Written Supervisory Procedures Reasonably Designed to Ensure Compliance with MSRB Rule G-17**

MSRB Rule G-27 requires each broker, dealer and municipal securities dealer to "adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance" with MSRB rules, and to "amend its written supervisory procedures as appropriate within a reasonable time after changes in [MSRB] or other applicable rules."

During the Relevant Period, Morgan Stanley failed to adopt, maintain, and enforce written supervisory procedures reasonably designed to ensure compliance with Rule G-17 as it relates to the conduct described above. Specifically, Morgan Stanley failed to establish reasonable procedures for reviewing and disclosing expenses for Cal PSA and other municipal securities associations for which it requested reimbursement from the proceeds of municipal and state offerings, and for ensuring that those requests were fair and adequate.

In addition, Morgan Stanley failed to adopt, maintain, and enforce adequate systems and written supervisory procedures reasonably designed to monitor how the municipal securities associations to which it belonged used the funds that Morgan Stanley provided to them. Adequate policies and procedures in this area were especially necessary in light of Cal PSA's engagement in political activities.

**B. Morgan Stanley also consents to the imposition of the following sanctions:**

- (1) A censure and;
- (2) A monetary fine in the amount of \$647,700 to be assessed against Morgan Stanley;
- (3) An order of restitution in the total amount of \$170,054.89, and to submit satisfactory proof of payment of restitution or of reasonable documented efforts to effect restitution to the issuers located in California to which Morgan Stanley has not yet provided restitution. Such proof shall be submitted to Gina M. Petrocelli, One World Financial Center, 200 Liberty Street, New York, New York 10281 either by letter that identifies "Morgan Stanley & Co. LLC, Disciplinary No. 20100220498" and includes a copy of the check, money order or other method of payment or by e-mail, with pdf copies of the payment documentation, to [EnforcementNotice@FINRA.org](mailto:EnforcementNotice@FINRA.org). This proof shall be provided to the FINRA staff member listed above no later

than 120 days after acceptance of the Offer. If for any reason Respondent cannot locate any such issuer after reasonable and documented efforts within 120 days from the date the Offer is accepted, or such additional period agreed to by a FINRA staff member in writing, Respondent shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the State of California. Respondent shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

- (4) Within 180 calendar days of the issuance of this AWC, an officer (or equivalent) of Morgan Stanley will certify to FINRA in writing that it has (a) completed a review of its written supervisory procedures and systems concerning the areas described above in Section I.A.c; and (b) implemented necessary revisions to such procedures and systems in order to ensure that the procedures and systems are in compliance with MSRB Rule G-27. The certification shall describe the specific actions taken by the Firm, including the systems and written procedures developed and implemented.

Respondent agrees to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are due and payable. Respondent has submitted an Election of Payment form showing the method by which we propose to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim that the Firm is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

## **II. WAIVER OF PROCEDURAL RIGHTS**

The Firm specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued;

and

- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Firm specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

The Firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

### **III.**

#### **OTHER MATTERS**

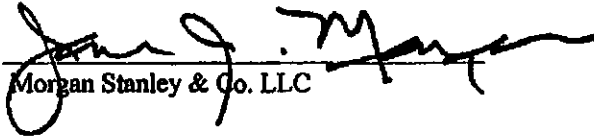
The Firm understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firm; and
- C. If accepted:
1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;
  2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
  3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and

4. the Firm 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 AWC or create the impression that the AWC is without factual basis. The Firm may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. The Firm understands that it may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understand all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

12/21/2012  
Date (mm/dd/yyyy)

  
Morgan Stanley & Co. LLC

Reviewed by:

  
Counsel for Respondent

By: JAMES J. MANGAN  
MANAGING DIRECTOR

Accepted by FINRA:

12/27/12  
Date

Signed on behalf of the  
Director of ODA, by delegated authority

  
Susan Light, Senior Vice President & Chief Counsel  
FINRA Department of Enforcement  
One World Financial Center  
200 Liberty Street, 11<sup>th</sup> Floor  
New York, New York 10281  
Tel: 646-315-7313