

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20100231257**

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

RE: Morgan Stanley & Co. LLC
CRD No. 8209

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Morgan Stanley & Co. LLC (the "Firm"), formerly known during relevant times as Morgan Stanley & Co. Incorporated, 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 the Firm 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

The Firm has been a member of FINRA since 1970, and its registration remains in effect. During relevant times, the Firm carried or cleared in excess of 3 million accounts of retail and institutional customers and operated out of branch offices worldwide. The Firm engaged in a wide range of activities including institutional sales and trading, investment banking, market making, investment advisory, and asset management services.

OVERVIEW

Between January 2008 and approximately September 2009, the Firm did not have adequate systems and procedures reasonably designed to result in the preparation of accurate customer reserve formula computations. This related to data sourcing

and data quality processes and to the use of spreadsheets to manage source data in order to derive balances used in the computations. A review by FINRA examiners of the spreadsheets used to perform the computations disclosed control weaknesses that resulted in inaccurate data being reported on the March 31, 2009 weekly and month-end computation. Some of the errors involved an overstatement of credits or an understatement of debits. The errors noted did not result in a Reserve Bank Account hindsight deficiency.

FACTS AND VIOLATIVE CONDUCT

Applicable Rules

Pursuant to Section 15(c) of the Securities Exchange Act of 1934 (the “Exchange Act”) the U.S. Securities and Exchange Commission adopted Exchange Act Rule 15c3-3. The Rule requires, as set forth in Rule 15c3-3(e), that every broker-dealer perform a weekly computation in accordance with the formula set forth in Rule 15c3-3a (the “reserve formula computation” or the “computation”). The reserve formula computation determines what amount, if any, the broker-dealer must deposit on behalf of customers in a *Special Reserve Bank Account for the Exclusive Benefit of Customers* (the “Reserve Bank Account”).

In general, the reserve formula computation requires a broker-dealer to calculate any amounts it owes customers, called credits, and compare that amount to any amounts its customers owe it, called debits. If credits exceed debits, the broker-dealer must deposit that net difference amount in the Reserve Bank Account. This deposit requirement protects customers by preventing the commingling of customer and firm funds.

NASD Conduct Rule 3010(a) (Supervisory System) requires that each member establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with NASD Rules.¹

Failure To Prepare Accurate Reserve Formula Computations

Between January 2008 and approximately September 2009, the Firm’s system of preparing the reserve formula computation involved as many as 100 Firm Operations personnel who supplied data for use by approximately five Firm Regulatory Controllers who were responsible for preparing the computation. The computation process was manually intensive and involved a variety of data

¹ A violation of an Exchange Act Rule or of a NASD/FINRA Rule is also a violation of either NASD Rule 2110 or FINRA Rule 2010. Due to a Rule conversion change, after December 15, 2008, NASD Rule 2110 became FINRA Rule 2010. Both Rules require members to observe high standards of commercial honor and just and equitable principles of trade.

collection sources, including, sometimes, excel spreadsheets, e-mails, faxes, and telephone calls. Spreadsheets were used to manage source data in order to derive balances used in the computation.

In January 2009, the Firm's internal audit group concluded, based on testing of the Firm's May and September 2008 reporting, that the data sourcing and data quality processes supporting the Firm's determination of its reserve formula computations to ensure accurate reporting were weak.

In or about July 2009, FINRA's Risk Oversight and Operational Regulation Department ("ROOR") commenced an examination of the Firm, which included a review of the Firm's reserve formula computation as of March 31, 2009. ROOR referred certain of its findings to FINRA's Department of Enforcement. The review by ROOR examiners of various Firm spreadsheets used to prepare the computation as of March 31, 2009 disclosed control weaknesses and other deficiencies as follows:

- a. The weekly reserve formula spreadsheet utilized to capture overdrafts contained an incorrect formula that omitted several rows with overdraft balances totaling approximately \$629 million. The Firm included approximately \$432 million of these credits in the month-end computation, but excluded the credits from the weekly computation. A subsequent analysis disclosed that the balances were not true overdrafts and should have been excluded from both computations.
- b. The monthly overdraft spreadsheet used to extract overdrawn balances maintained an incorrect formula that also captured non-overdrawn balances. This resulted in credits being understated on the month-end computation by approximately \$196 million.
- c. A mapping error in a spreadsheet used to analyze and adjust allocations for reserve formula purposes resulted in CNS fail to deliver/receive allocations being duplicated on the file. These duplicative allocation pairings were included in the weekly computation, resulting in credits being overstated by \$36 million and debits being understated by \$25 million.
- d. The monthly spreadsheet formula utilized to compute aged short suspense items was incorrectly formatted to graduate charges over 28 days rather than the appropriate seven days. This resulted in the Firm understating credits in the month-end computation by approximately \$1.4 million.
- e. The following spreadsheet issues were related to the bank reconciliation process: (i) The query utilized to extract balances from the aged cash schedule only captured accounts that were reconciled via the Intellimatch System. The accounts reconciled manually were omitted from the schedule. (ii) The formula used to extract aged bank reconciling items was mapped to the incorrect worksheet which excluded several accounts. This resulted in credits being understated by approximately \$515,000 in both the weekly and month-end computations.

- f. A series of formulas were not linked correctly in a spreadsheet used for the weekly CNS analysis, causing the Firm to not exclude non-customer related balances from the CNS fails to deliver total. This resulted in debits being overstated by approximately \$421 million in the weekly computation.
- g. The Firm did not exclude fail to deliver balances aged over 30 calendar days from the weekly and month-end computations. As a result, debits were overstated by approximately \$68 million. The Firm concluded that its aged fail to deliver analysis was based upon a report designed for the Institutional Securities Group as opposed to the full allocation process which also included Global Wealth Management.

The foregoing errors in the computations did not result in a Reserve Bank Account hindsight deficiency.

In the fourth quarter of 2008 the Firm commenced a project to automate the reserve formula computation process. The automated process replaced the existing manual spreadsheet-based process in or about September 2009. Until that change occurred, including during the reserve formula computation period as of March 31, 2009, the Firm was required to have systems and procedures in place reasonably designed, in light of the existing manual spreadsheet-based process, to result in an accurate reserve formula computation.

Violative Conduct by the Firm

As a result of the conduct described above, the Firm violated:

- 1. Section 15(c) of the Exchange Act and Rule 15c3-3 promulgated thereunder, and NASD Rule 2110 and FINRA Rule 2010, in that the Firm prepared inaccurate reserve formula computations.
- 2. NASD Rule 3010(a) and NASD Rule 2110 and FINRA Rule 2010, in that the Firm did not have adequate systems and procedures in place reasonably designed to result in the preparation of accurate customer reserve formula computations.

B. The Firm also consents to the imposition of the following sanctions:

- a. Censure;
- b. Fine in the amount of \$65,000.

The Firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. The Firm has submitted

an Election of Payment form showing the method by which it proposes to pay the fine imposed.

The Firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction 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 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:

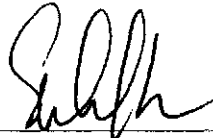
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will 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 the Firm;
 - 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 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 understands 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.

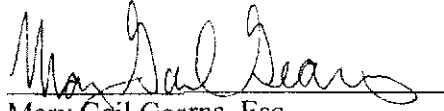
11/28/2011
Date

Morgan Stanley & Co. LLC

By: _____


S. Anthony Taggart
Executive Director

Reviewed by:

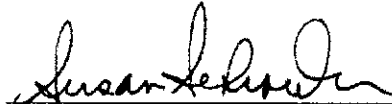


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Accepted by FINRA:

12/9/11
Date

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



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