

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2011029749101**

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

RE: Morgan Stanley Smith Barney LLC (BD No. 149777),
Respondent

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Morgan Stanley Smith Barney LLC ("MSSB" or the "Firm" or "Respondent") 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. MSSB 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

MSSB has been a FINRA member since May 2009. MSSB was formed by the combination of the Global Wealth Management Group of Morgan Stanley & Co., Inc. and the Smith Barney Division of Citigroup Global Markets, Inc. MSSB operated as a joint-venture until 2013, when holding company Morgan Stanley purchased Citigroup Inc.'s remaining interest in MSSB. The Firm has about 800 branch offices and employs approximately 20,000 registered individuals.

This matter involves MSSB's supervision of a client's account held at the Firm's branch office in Asheville, North Carolina.

RELEVANT DISCIPLINARY HISTORY

MSSB has no prior relevant disciplinary history with the Securities and Exchange Commission, any self-regulatory organization, or any state securities regulator.

OVERVIEW

In 2009 and 2010, MSSB violated NASD Conduct Rule 3011(a) and FINRA Rules 3310(a) and 2010 because it failed to adequately supervise by following Firm policies and procedures to detect and cause the reporting of potentially suspicious transactions.

Specifically, an MSSB client (the “Client”) at the Firm’s branch in Asheville, North Carolina was able to kite checks between his Firm account and a separate bank account, in furtherance of a fraudulent “Ponzi” scheme, despite his activity raising red flags identified in Firm policies and procedures as being indicative of potentially suspicious activity.

FACTS AND VIOLATIVE CONDUCT

FINRA Rule 3310, formerly NASD Conduct Rule 3011, requires each member firm to “develop and implement a written anti-money laundering [(“AML”)] program reasonably designed to achieve and monitor the member’s compliance with the requirements of the Bank Secrecy Act . . . , and the implementing regulations promulgated thereunder by the Department of the Treasury.” Rule 3310(a) requires each member to establish and implement policies and procedures “that can be reasonably expected to detect and cause the reporting of” suspicious activity and transactions.

Notice to Members 02-21 states that AML procedures, to be effective, “must reflect the firm’s business model and customer base.” Notice to Members 02-21 further states that “in developing an appropriate AML program . . . , [a firm] should consider factors such as its . . . business activities, the types of accounts it maintains, and the types of transactions in which its customers engage.” The Notice emphasizes each firm’s duty to detect “red flags” that might be a sign of money laundering; and, if a firm detects any such red flags, to “perform additional due diligence before proceeding with the transaction.”

The Client maintained a Financial Management Account at an MSSB branch in Asheville, North Carolina (the “MSSB Account”). The Client also maintained a separate bank account at a local bank (the “Bank Account”). The Client represented to MSSB that his business model was to facilitate “like kind” real estate exchanges pursuant to Section 1031 of the Internal Revenue Code. The Client also participated in real estate investments and other investments with his investors. However, in fact, the Client did not invest the money as represented to his investors. Instead, the Client had been engaged in a fraudulent “Ponzi” scheme that he kept afloat in part by moving money between the MSSB Account and the Bank Account.

From 2001 to 2008, the MSSB Account had about \$10.7 million in total deposits and about \$10.2 million in total withdrawals. By contrast, in 2009 and 2010, the MSSB Account had about \$429 million in total deposits and about \$424 million in total withdrawals. Further, during this period of increased deposit and withdrawal activity, the MSSB Account had almost no securities transactions. Instead, the Account was used almost exclusively to transfer funds between the MSSB Account and the Bank Account.

In fact, the Client was kiting checks. The Client would deposit checks from the Bank Account into the MSSB Account and, almost immediately, write a check from the MSSB Account back to the Bank Account. MSSB permitted the Client to write checks

against uncleared funds. For example, in the month of June 2010, the Client deposited 27 checks from the Bank Account (totaling about \$25.6 million) into the MSSB Account and wrote 29 checks from the MSSB Account (totaling about \$25.4 million) back to the Bank Account.

The activity in the MSSB Account triggered red flags indicative of potentially suspicious activity that were, appropriately, identified in MSSB's written AML policies and procedures that are issued to Firm employees. These red flags were:

- Transactions that were inconsistent with the client's known and normal practices;
- The movement of a significant amount of funds through the account relative to a low level of securities transactions; and
- The immediate transfer out of an account of recently deposited funds.

In addition, between February 2009 and December 2010, the Firm's electronic alert system generated approximately 75 separate alerts as a result of the rapid movement of funds through the MSSB Account.

As a result of these alerts, the Firm reviewed the Client relationship in late 2009 and met with the Client in early 2010; the Asheville branch received what it believed was a plausible business explanation for the activity. However, the alerts and the above-described red flags indicative of potentially suspicious activity continued until December 2010.

In August 2010, as a result of these alerts, branch and complex management again reviewed the activity in the Client's MSSB Account. As a result of this review, in November 2010 the Firm concluded that it would no longer pay the Client's checks on uncleared funds and advised the Client. The Client's Ponzi scheme then collapsed when he bounced several checks.

By virtue of the foregoing, MSSB violated NASD Conduct Rule 3011(a) (for the conduct on or before December 31, 2009), FINRA Rule 3310(a) (for the conduct on or after January 1, 2010), and FINRA Rule 2010.

B. MSSB also consents to the imposition of the following sanctions:

- a censure; and
- a \$200,000 fine.

The Firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. MSSB has submitted an Election of Payment form showing the method by which the Firm proposes to pay the fine imposed.

MSSB 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

MSSB 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, MSSB specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, 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.

MSSB 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

MSSB 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 accordance with FINRA Rule 8313;
 - 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: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party; and
- D. MSSB 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.

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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 MSSB 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.

Morgan Stanley Smith Barney LLC

6/1/16
Date

By: [Signature]

Name: Allison D. Patton

Title: Managing Director

Reviewed by:

[Signature]

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Accepted by FINRA:

June 22, 2016
Date

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

[Signature]

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