

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2012031184001**

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, Respondent Morgan Stanley Smith Barney LLC ("MSSB" 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 MSSB 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 became a member of FINRA and the NYSE on May 19, 2009. MSSB was created through the contribution of the Global Wealth Management Group of Morgan Stanley & Co. LLC (BD No. 8209) ("MS&Co.") and the Smith Barney Division of Citigroup Global Markets, Inc. (BD No. 7059) ("CGMI") into a joint venture. In June 2013, Morgan Stanley, a publicly held company, completed the purchase of CGMI's portion of the joint venture and became the sole owner of MSSB (through direct and indirect subsidiaries). The Firm employs over 24,000 registered individuals who work out of approximately 850 branch offices. The Firm engages in a general securities business and its registration with FINRA remains in effect.

RELEVANT DISCIPLINARY HISTORY

In May 2012, FINRA issued an AWC against the Firm and its predecessor, MS&Co. (collectively, the "firms"), that censured the firms and fined them \$175,000 (\$25,000 jointly and severally). FINRA found that the firms violated Securities Exchange Act Rule 10b-10 by negligently entering incorrect information about a security into their computer systems, which caused them to disseminate inaccurate information to brokers and customers, and resulted in the

distribution of inaccurate customer transaction confirmations and account statements. The firms' misconduct took place from January 2004 through August 2010.

The Firm has no other relevant formal disciplinary history with the Securities and Exchange Commission, any self-regulatory organization or any state securities regulator over the past five years.

OVERVIEW

From at least June 2009 through at least November 2013 (the "Relevant Period"), MSSB violated FINRA, SEC, and Incorporated NYSE rules regarding certain customer account statements and transaction confirmations. As discussed in greater detail below, these deficiencies impacted transactions within the Firm's Global Stock Plan Services Group ("GSPS"), and certain option transactions which went through one of the Firm's programs and two of the Firm's exception trade processing systems.

First, MSSB failed to issue account statements and confirmations for numerous GSPS customer accounts and transactions. Second, when the Firm did issue GSPS account statements and confirmations, they failed to disclose required information including whether the Firm acted in an agency or principal capacity, and the market value of the securities so as to provide the dollar amount of the opening and closing account balances. Third, the Firm failed to indicate whether certain option transactions, which were processed through one of the Firm's programs and two of the Firm's exception trade processing systems, were opening or closing transactions. Fourth, MSSB failed to establish, maintain and enforce a reasonable supervisory system and written procedures to achieve compliance with applicable customer account statement and transaction confirmation rule requirements. Those supervisory failures allowed MSSB's violations to continue unchecked throughout the Relevant Period. These deficiencies affected millions of customers and transactions during a time period of approximately four and a half years.

FACTS AND VIOLATIVE CONDUCT

MSSB's Global Stock Plan Services Group

The Firm provides certain services to companies that offer stock option, employee stock purchase and restricted stock plans to their employees ("Plan Participants"), through GSPS. For example, MSSB acts as the executing broker-dealer for employer companies that purchase stock for their employee stock purchase plans. GSPS then allocates the shares of those stocks to individual Plan Participants. MSSB also acts as the executing broker-dealer for Plan Participants who choose to sell shares of stock acquired via the exercise of their vested stock options or who sell shares of their restricted stock awards. In addition, MSSB performs cashiering functions for those Plan Participants. MSSB also sends transaction confirmations, quarterly account statements, and year-end account statements to the Plan Participants regarding their GSPS transactions and account activity. As of July 2012, the Firm performed these and related services for 460 companies, with over 1.8 million Plan Participants. The Plan Participants are customers of the Firm.

In July 2011, MSSB evaluated whether to stop printing and mailing GSPS quarterly account statements as a cost savings measure. GSPS vetted this idea with the Firm's legal department, which requested additional information. GSPS did not provide that additional information and, consequently, the Firm's legal department did not provide GSPS with an opinion about whether GSPS could suppress its printing and mailing of quarterly account statements.

Nevertheless, beginning in July 2011, GSPS instructed the Firm's technology department not to issue the quarterly GSPS account statements for Plan Participants who conducted cashless stock option exercises and vested restricted stock sales. For the second quarter of 2011, MSSB failed to issue quarterly account statements for 44,718 of those Plan Participants' accounts. For the third quarter of 2011, MSSB failed to issue quarterly account statements for 27,765 of those Plan Participants' accounts.

MSSB Notifies FINRA about the GSPS Account Statement Suppressions

In or about April 2012, GSPS reversed its decision to suppress quarterly account statements and began issuing them again. In July 2012, MSSB notified FINRA that "for the second and third quarters in 2011, [certain GSPS] Plan Participants who conducted cashless stock option exercises (shares received in the exercise are all sold, and the Plan Participant receives the proceeds, net of the option strike price, transaction costs, and any tax withholdings) or who sold all of their vested restricted stock did not receive account statements, in violation of NASD Rule 2340." MSSB stated, however, that while Plan Participants did not receive quarterly statements, they did receive confirmations and year-end statements reflecting the transactions conducted. MSSB's statement regarding the Plan Participants' receipt of confirmations, however, was not accurate.

MSSB Failed to Issue Certain GSPS Transaction Confirmations

In about May 2013, two Plan Participants contacted the Firm because they each had not received confirmations for recent transactions. Thereafter, MSSB, which was already reviewing its transaction confirmation systems within GSPS, discovered that its representations to FINRA in July 2012 were not accurate. In fact, from at least June 2009 through June 2013, 133,767 GSPS transaction confirmations were not issued to certain GSPS Plan Participants. The Firm attributed the cause of this deficiency to a technical problem.

GSPS Transaction Confirmation and Statement Deficiencies

Even when GSPS issued certain transaction confirmations and account statements for Plan Participants, they were deficient. GSPS issued account statements and confirmations to certain GSPS Plan Participants that failed to disclose required information about their employee stock transactions. In October 2013, MSSB notified FINRA that it had discovered certain deficiencies with regard to GSPS transaction confirmations and quarterly account statements involving Plan Participants with long share positions in accounts processed through a Firm application known as "SP10." SP10 is one of the three software applications MSSB uses to generate transaction confirmations and account statements within GSPS.

During the Relevant Period, MSSB used the SP10 application to generate confirmations and statements for Plan Participants who had employee stock purchase and restricted stock transactions. The SP10 application issued:

- “SP Statements,” which served as both confirmations and quarterly statements for Plan Participant accounts with long share positions that had activity during the quarter; and
- Quarterly “Inactivity Statements,” which were sent to Plan Participants with long share positions who had no activity during the quarter.

In particular, MSSB notified FINRA that the Firm failed to disclose, or inadequately disclosed, whether it acted as principal or agent in connection with over 12.2 million GSPS transactions on the SP Statements that the Firm issued to Plan Participants between June 2009 and November 2013. Approximately 10.7 million of these transactions were associated with dividend reinvestment activity. In addition, between June 2009 and November 2013, the Firm also failed to include the market value of securities positions so as to provide the dollar amount of the opening and closing account balances on the SP Statements which were sent to 2.2 million GSPS Plan Participants who held long share positions and had activity in their accounts. Finally, between June 2009 and November 2013, MSSB failed to include the market value of securities positions so as to provide the dollar amount of the opening and closing account balances on all 5.4 million of the Inactivity Statements it issued, affecting approximately 1 million GSPS Plan Participants who held long share positions and who did not have activity in their accounts. The Firm did not determine the cause of those deficiencies.

Additional Confirmation Deficiencies

Distinct from its GSPS business, MSSB also failed to disclose required information in option transaction confirmations related to the Firm’s Portfolio Management program (“PM”) and two of the Firm’s exception trade processing systems. In January 2012, MSSB notified FINRA that it had “concluded that the Firm may have violated FINRA Rule [2360(b)(12)] by not including opening and closing data on certain customer option confirmations.”

MSSB discovered this deficiency during an internal audit of PM. Option trading through PM is limited to selling covered calls and buying protective puts on a discretionary basis. PM option orders are primarily processed as block trades, and at the block level, the trades would show whether they were “opening” or “closing” transactions. When PM allocated those option trades to individual customer accounts, however, the “opening” or “closing” information was dropped. As such, all of the confirmations that MSSB issued to customers for option trades in PM between June 2009 and February 2012 failed to show whether a trade was an “opening” or a “closing” transaction. Moreover, the Firm identified two trade processing systems with the same reporting deficiency:

- the Post Trade Execution Trade Entry system (“PSOE”);¹ and
- the Automated Trade Adjustment system (“ATA”).²

Between the PM program, and PSOE and ATA systems, MSSB issued 1,098,295 option confirmations during the time period of June 2009 through September 2012 that failed to disclose whether the transactions were opening or closing transactions. These deficient confirmations concerned approximately 10% of the option transactions that the Firm effected during that time period. The Firm attributed this deficiency to a technical problem.

MSSB's Reporting Violations Resulted in Part from Its Supervisory Failures

Throughout the time periods discussed above, MSSB failed to establish, maintain and enforce a reasonable supervisory system and written procedures to achieve compliance with applicable customer account statement and transaction confirmation rule requirements. For example, the Firm lacked controls to routinely review confirmations or account statements and verify that they were being properly issued to customers. The Firm also lacked controls to ensure that the confirmations and account statements that it sent to customers contained all of the disclosures required by applicable rules. Because of these supervisory failures, MSSB's reporting violations continued unchecked for years.

Violations

SEC, FINRA, and Incorporated NYSE rules require member firms to disclose certain information in transaction confirmations and account statements. Securities Exchange Act Rule 10b-10, NASD Conduct Rule 2230, and FINRA Rule 2232, require broker-dealers to provide customers with written notification disclosing, among other things, whether a firm is acting as a principal or agent in a transaction. NASD Conduct Rule 2340(a) requires each member firm to send a statement of account containing a description of any securities positions, money balances, or account activity to each customer whose account had a security position, money balance, or account activity. Incorporated NYSE Rule 409 requires member organizations to send their customers statements of account showing security and money positions and entries to all accounts having an entry, money or security position.

¹ PSOE is a manual trade processing system used by the Firm to process trades on an exception basis for orders that were not previously executed. It had no order routing capability directly or indirectly to exchanges and was used to manually process transactions, for example, that were entered but previously rejected.

² ATA is a manual, post-execution system. ATA allows users to adjust trades in which confirmations were previously generated (i.e. cancels and rebills) on an exception basis. The Firm stated that all of the ATA trades were cancel and rebill transactions that were originally booked through another system. A small portion of the initial trades that were adjusted via ATA were initially effected via PM and therefore had confirmations that failed to indicate whether the trade was an opening or closing transaction. The ATA adjusted trades also generated confirmations that failed to indicate whether the trade was an opening or closing transaction.

Through its GSPS, MSSB Violated Securities Exchange Act Rule 10b-10, FINRA Rules 2232 and 2010, NASD Conduct Rules 2340(a) and 2230, and Incorporated NYSE Rule 409 by:

- a. Failing to Issue Quarterly Account Statements During Two Calendar Quarters – During the second quarter of 2011, MSSB did not issue quarterly statements to 44,718 GSPS Plan Participants that had engaged in securities transactions. During the third quarter of 2011, MSSB failed to issue quarterly account statements to 27,765 GSPS Plan Participants that had engaged in securities transactions;
- b. Issuing Deficient Quarterly Account Statements for Customers with Activity–From at least June 2009 through November 2013, MSSB issued SP Statements that served as quarterly account statements for GSPS customers who held long share positions and had activity in their accounts. Those SP Statements, however, failed to include the market value of securities positions so as to provide the dollar amount of the opening and closing account balances. MSSB's failures occurred on all of the SP Statements that the Firm issued during that period, and affected 2.2 million Plan Participants;
- c. Issuing Deficient Quarterly Account Statements for Customers with No Activity – From at least June 2009 through November 2013, MSSB's SP Statements also served as quarterly account statements for certain GSPS customers who held long share positions and did not have activity in their accounts. Like the SP Statements for customers who had activity in their accounts, MSSB failed to disclose the market value of securities positions so as to provide the dollar amount of the opening and closing account balances on the SP Statements of GSPS Plan Participants who had no account activity. Those failures occurred in connection with all of the Inactivity Statements that the Firm issued through its SP10 system, totaling approximately 5.4 million statements. MSSB's deficiency affected approximately 1 million Plan Participants;
- d. Failing to Issue Transaction Confirmations –From at least June 2009 through June 2013, MSSB failed to issue confirmations for 133,767 of 3,673,188 (3.6%) of certain GSPS transactions; and
- e. Issuing Deficient Confirmations –From at least June 2009 through November 2013, in connection with 12.2 million out of 14.6 million GSPS SP10 transactions which were conducted for 1.1 million Plan Participants, MSSB failed to disclose, or inadequately disclosed, on its SP Statements, whether the Firm acted as principal or as agent.

MSSB Issued Deficient Option Transaction Confirmations and Violated FINRA Rules 2360(b)(12) and 2010

FINRA Rule 2360(b)(12) requires member firms to promptly furnish written confirmations to customers showing whether an option transaction is an opening or a closing transaction.

During the time period of June 2009 through September 2012, MSSB issued deficient option confirmations. Those confirmations, which were issued through the PM program, and PSOE and ATA systems, lacked information about whether transactions were opening or closing transactions.

In total, MSSB issued 1,098,295 confirmations for options on common stock that failed to disclose this information.

MSSB Violated FINRA Rule 2010 and NASD Conduct Rule 3010 by Failing to Establish, Maintain and Enforce a Reasonable Supervisory System and Written Procedures

Throughout the above-referenced time periods, MSSB failed to establish, maintain and enforce a reasonable supervisory system and written procedures to achieve compliance with applicable confirmation and customer account statement rules.

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

- a censure; and
- a fine in the amount of \$800,000.

The Firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment(s) are 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

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 it;
- 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 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.

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 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: (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.

- 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 it 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

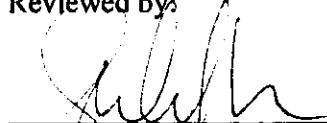
10/3/2014
Date (mm/dd/yyyy)

By:



Scott Tucker
Managing Director

Reviewed by:

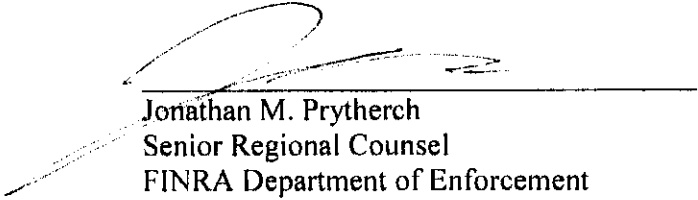


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Accepted by FINRA:

10/16/2014
Date

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



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