

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014040071001**

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

RE: Morgan Stanley & Co., LLC, Respondent
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. Respondent 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, a FINRA member since June 1970, is a full service broker-dealer headquartered in New York, New York that provides equity sales, trading and research services as well as underwriting services. The Firm currently has 39 branch offices and approximately 4,000 registered representatives.

RELEVANT DISCIPLINARY HISTORY

The Firm has no relevant disciplinary history.

OVERVIEW

From 2010 through 2013 (the "Relevant Period"), Respondent failed to establish and maintain systems and procedures reasonably designed to ensure it accurately valued its holdings in

Commercial Mortgage Backed Securities ("CMBS") and Residential Mortgage Backed Securities ("RMBS"). Although the Firm had a Valuation Review Group ("VRG") that independently reviewed the Firm's trading desk's valuations, it reviewed valuations at an aggregate level that was insufficient to identify potentially material discrepancies at an individual instrument level. This weakness in controls increased the Firm's risk of inaccurate CMBS and RMBS pricing and inaccurate financial calculations for balance sheet, profit and loss ("P&L"), FOCUS reporting, market risk management and haircut purposes.

By reason of the foregoing, the Firm violated NASD Rule 3010(a) and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

In order to determine the market value of certain illiquid or complex securities such as CMBS and RMBS, the Firm's traders priced or "marked" each security the Firm owns. Then VRG, a control group independent of the trading desks, independently assessed the prices of those securities in order to assess the reasonableness of the traders' marks. VRG was responsible for challenging the traders' marks when the traders' marks differed from VRG's marks by a certain threshold.

During the Relevant Period, however, VRG did not review each individual CMBS or RMBS position, compare it to the corresponding trader's mark and adjust each position individually. Instead, VRG netted all CMBS cash positions into one category and, separately, RMBS cash positions into more than one category. VRG then compared the aggregate trader marks for that category to the aggregate VRG marks. VRG only adjusted the trader marks if the total differed from the total VRG marks by a certain threshold determined by a formula. These thresholds were so large that aggregate trader marks rarely differed from aggregate VRG marks by the threshold amount, and VRG rarely adjusted the traders' marks.

For example, in January 2010, the difference between traders' marks and VRG's marks for CMBS was \$141 million. However, the threshold generated by the formula was \$215 million. Because the discrepancy did not meet that threshold amount, VRG did not examine or adjust any trader marks even though traders' marks on two individual securities exceeded the VRG prices by 22% and 28%.

The practice of netting all CMBS or RMBS cash positions created a risk that the Firm might not identify material discrepancies in a certain security or category of securities, because specific discrepancies could be concealed by the netting effect. Thus, the Firm had inadequate market-risk management controls over its trading positions that inhibited its ability to reasonably assess the price variances of each security over time.

Although in 2011 and 2013 VRG changed this process to aggregate CMBS and RMBS into smaller sub-categories, the sub-categories were still broad and the Firm's practices continued to create a risk that substantial discrepancies in one security or type of security would not be apparent after netting.¹

¹ In 2014, the Firm incorporated additional procedures designed to address FINRA's concerns.

Further, when VRG did identify and discuss price variances on individual positions with desk traders, it routinely accepted the traders' explanations of mitigating market factors without performing independent reviews and without sufficiently documenting the reasons for accepting the traders' marks.

NASD Rule 3010(a) requires firms to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. A violation of NASD Rule 3010(a) is also a violation of FINRA Rule 2010, which requires FINRA member firms to "observe high standards of commercial honor and just and equitable principles of trade."

By failing to have in place supervisory systems and procedures reasonably designed to assess the reasonableness of trader marks on CMBS and RMBS positions, the Firm violated NASD Rule 3010(a) and FINRA Rule 2010.

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

- a. A censure, and
- b. A fine in the amount of \$500,000.

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 it proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim that it 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

Respondent 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, Respondent 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.

Respondent 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:

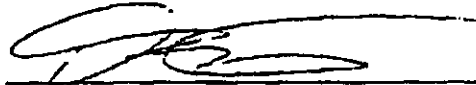
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will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

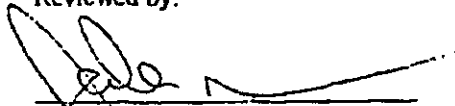
The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that I have agreed to its provisions voluntarily; and that no offer, threat, 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.

12/8/2016
Date (mm/dd/yyyy)


Morgan Stanley & Co. LLC

By: Scott Tucker
Global Head of Litigation

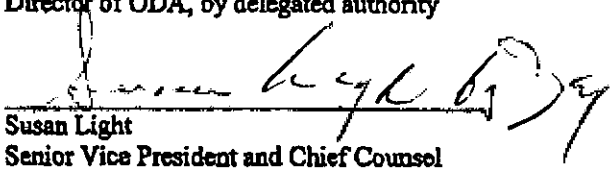
Reviewed by:


Jonathan M. Moses
Counsel for Respondent
Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, New York 10019
212-403-1388

Accepted by FINRA:

12/8/2016
Date

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



Susan Light
Senior Vice President and Chief Counsel
FINRA Department of Enforcement
Brookfield Place
200 Liberty Street
New York, New York 10025
646-315-7333; Fax Number