

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT**

NO. 2014040071002

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

RE: Morgan Stanley & Co. LLC, Respondent
Member Firm
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 research, sales and trading 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 at least 2012 through 2013 (the "Relevant Period"), Morgan Stanley failed to establish and maintain systems and procedures reasonably designed to ensure that it maintained possession and control of all customer fully paid and excess margin securities. At times, the Firm erroneously released certain customer shares that should have been held in a segregated account. As a result, the shares were made available for the Firm's use and at times were used by the Firm.

By reason of the foregoing, the Firm violated Section 15 of the Exchange Act and Rule 15c3-3(b) thereunder, NASD Rule 3010(a) and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Section 15 of the Securities Exchange Act of 1934 and Rule 15c3-3(b)(1) thereunder requires broker-dealers to promptly obtain and thereafter maintain physical possession or control of all fully-paid and excess margin securities¹ it carries for the accounts of customers. This requirement, known as the Customer Protection Rule, requires broker-dealers to protect securities that customers leave in the firm's custody. To comply with this rule, broker-dealers segregate these customer securities and hold them in a separate account from the broker-dealer's own assets.

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."

During the Relevant Period, the Firm's systems erroneously released certain customer securities from the segregated account.

Domestic Securities

In order to comply with the Customer Protection Rule, the Firm maintained a control system that calculated what customer securities it was required to segregate. To the extent the Firm also had excess securities, over and above the amount it was required to segregate, the Firm could "release" those securities from segregation.

However, the Firm's system contained a design flaw that allowed the Firm to release certain securities from segregation that the system deemed to be excess, when in fact no such excess existed. The Firm's release of these securities resulted in deficits in the customer securities it was required to segregate. These situations occurred when the Firm erroneously understood that customer securities had been segregated, but the segregation instructions had in fact not yet been processed. Based upon that belief, the Firm erroneously released the shares from segregation. As a result, the shares were made available for the Firm's use and at times were used by the Firm. The Firm then corrected the deficit by end of day.

For example, in January 2012 the Firm erroneously released a customer's fully paid-for securities to facilitate a pledge to the Options Clearing Corporation. The segregation release and subsequent deliveries created an intraday deficit of \$41.2 million. Other intraday deficits created during January 2012 ranged in value from \$100,000 to \$1.573 million.

¹ Generally, fully paid securities are those that are held in cash accounts. The term "excess margin securities" refers to securities carried in a customer's account having a market value in excess of 140% of the customer's net debit balance in that account.

Although the Firm typically segregated the customer shares at the end of day, thereby correcting intraday deficits, it did not have adequate systems and procedures in place to investigate the cause of the intraday deficits or to prevent the creation of other similar intraday deficits going forward.

International Deficits

After each trading day, the Firm's segregation system calculates what shares are available for the Firm's use for the next trading day. It completes its process at about 3 a.m. on the next business morning following each trading day. This process occurs in New York and the information gathered is distributed to the Firm's settlement departments maintained overseas. The Firm relies on this information generated by the segregation system to move excess shares to and from the customer segregation location. However, the Firm failed to have in place adequate systems and procedures that accounted for trading in disparate time zones and on U.S. holidays, to prevent the creation of deficits in customer securities.

Deficits Related to Disparate Time Zones

The Firm's segregation systems did not account adequately for time zone differences. When it effected certain transactions at times outside the U.S. trading day, the Firm's overseas based settlement department relied on stale information. This issue predominantly affected countries in Asia with time zones that were 13 hours or more ahead of New York City, where the Firm ran its segregation process. The Firm created or increased deficits when it engaged in these transactions. For example, the Firm created and/or increased 23 deficits over the course of six days in January 2012 as a result of this issue. The market value of these deficits totaled \$10.8 million.

Although the Firm implemented a temporary manual process to minimize the impact of this time zone problem, that process was only 80% effective in the Asia markets.

Deficits Created During U.S. Holidays

The Firm's segregation system did not run on U.S. holidays. When, for example, a U.S. holiday fell on a Monday, the Firm did not process Friday's transactions through its segregation system until early Tuesday morning. Therefore the Firm did not provide its overseas-based settlement departments with accurate share availability information on U.S. holidays. The Firm created deficits in customer securities when its overseas-based settlement departments relied on this inaccurate information and utilized shares that were not actually available.

For example, on January 13, 2012, the Friday prior to the Martin Luther King, Jr. holiday, a Firm customer delivered out 500,000 shares of ABC. The Firm did not process this transaction through its segregation systems until Tuesday morning. On the Monday holiday, the Firm's overseas-based settlement personnel were unable to view accurate share availability information. The Firm created a deficit valued at \$1.8 million when 1.5 million shares of ABC were moved

out of the Firm's customer segregation location. The Firm created an additional 34 delivery deficits totaling approximately \$16 million on this Monday holiday.

Additional Possession and Control Violations

Following the FINRA 2012 cycle examination, Morgan Stanley self-reported that it had identified additional violative deficits. First, from August 2 to August 8, 2012, the Firm created deficits in three securities averaging \$932,000 per day when it erroneously removed all non-U.S. dollar denominated customer securities segregated at DTC from segregation. Second, the Firm created seven intraday deficits totaling \$1.5 million on September 4, 2012 due to a failure to deliver recently purchased Deposit/Withdrawal at Custodian ("DWAC") customer shares to transfer agents.

By the foregoing, the Firm violated Section 15 of the Exchange Act and Rule 15c3-3(b) thereunder, NASD Rule 3010(a) and FINRA Rule 2010.

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

- a. A censure; and
- b. A fine of \$2,750,000.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is 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 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

Respondent 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 Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against me;
 - 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. Respondent 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

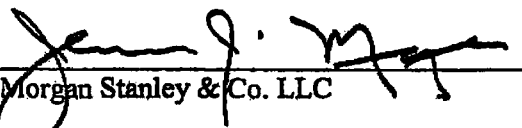
that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. Respondent 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.

11/30/2016
Date (mm/dd/yyyy)


Morgan Stanley & Co. LLC
By: JAMES J. MANGAN
MANAGING DIRECTOR

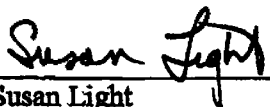
Reviewed by:


Ben Indek, Esq.
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(212) 309-6109

Accepted by FINRA:

12/19/16
Date

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


Susan Light
Senior Vice President and Chief Counsel
FINRA Department of Enforcement
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