

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20140426518 01**

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

**RE: Morgan Stanley Smith Barney, Respondent
Member Firm
BD No. 149777**

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Morgan Stanley Smith Barney ("MSSB" 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 Respondent 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

MSSB has been a FINRA member since May 2009. In June 2009, the Global Wealth Management Group of Morgan Stanley & Co., Inc. and the Smith Barney Division of Citigroup Global Markets, Inc. were combined to form MSSB. MSSB operated as a joint venture until 2013, when holding company Morgan Stanley purchased Citigroup Inc.'s remaining interest in MSSB. MSSB has approximately 767 branch offices and employs approximately 20,000 registered persons.

RELEVANT DISCIPLINARY HISTORY

MSSB does not have any relevant disciplinary history with the U.S. Securities and Exchange Commission, FINRA, any other self-regulatory organization or any state securities regulator.

OVERVIEW

This matter principally concerns systems failures and supervisory deficiencies at MSSB that caused the Firm's failure to deliver prospectuses to customers as well as failures to ensure delivery of required investment objective change letters to customers.

FACTS AND VIOLATIVE CONDUCT

MSSB Failed to Deliver Prospectuses in Violation of FINRA Rule 2010 and Failed to Implement a Reasonable Supervisory System Ensuring Delivery of Prospectuses

Under Section 5(b)(2) of the Securities Act of 1933 (the "Securities Act"), delivery of certain products including mutual funds, exchange-traded funds, unit investment trusts and closed end funds is prohibited unless such delivery is accompanied or preceded by a copy of a prospectus, or a written description that meets the requirements of Section 10(a) of the Securities Act.

For several years prior to 2013, MSSB made required prospectuses available to customers through an online platform ("MS Online") if the customer elected to receive paperless transaction confirmations via online delivery ("online customers"). When an online customer received notification of a transaction confirmation the customer could logon to MS Online and view the transaction confirmation. In the event the transaction concerned a purchase that required a prospectus to be delivered, the online transaction confirmation would include an easily accessible hyperlink to the relevant prospectus (the "View Prospectus Hyperlink"). While the prospectus was available elsewhere on MS Online, the View Prospectus Hyperlink was the Firm's designated means for ensuring compliance with its prospectus delivery requirements to online customers.

In November 2013, MSSB deployed a system update to MS Online to change various features unrelated to the View Prospectus Hyperlink. The Firm did not test the View Prospectus Hyperlink in MS Online after deployment of changes to ensure that prospectuses remained available to online customers via the View Prospectus Hyperlink. As a result of the system update, the View Prospectus Hyperlink was not placed on the online transaction confirmation. The View Prospectus Hyperlink was not placed on the online transaction confirmation between November 8, 2013 and August 14, 2014. On August 12, 2014, a customer seeking to view a prospectus contacted MSSB, prompting MSSB staff to recognize that the View Prospectus Hyperlink was not present. During the nine month period at issue, the Firm failed to deliver to online customers approximately 2.1 million prospectuses via the View Prospectus Hyperlink.

As a result of MSSB's failure to test whether the View Prospectus Hyperlink was functional following its November 2013 system update, the Firm violated NASD

Rule 3010 and FINRA Rule 2010. Additionally, the Firm violated FINRA Rule 2010 for contravening Section 5(b)(2) of the Securities Act.

MSSB Failed to Deliver Investment Objective Change Letters and Failed to Implement a Reasonable Supervisory System to Ensure Their Delivery

The Firm Failed to Send Change Letters if Investment Objective Changes were Not Approved on the Same Day Requested

Section 17(a) of the Securities Exchange Act of 1934 (the "Exchange Act") and the rules promulgated thereunder require, in relevant part, that broker-dealers confirm to customers, in writing, any changes made to a customer's investment objectives within 30 days of such a change. Respondent MSSB employed an automated system to ensure that investment objective change letters were delivered. During the fourth quarter of 2013, the Firm made a system change that resulted in failures in delivering investment objective change letters under certain circumstances. During the period between November 2013 and December 2014, when an investment objective change was entered by a financial advisor with respect to a customer's account, a supervisor was notified of the change and required to review it, and if appropriate, approve it. When the supervisor approved the investment objective change on the same day that the financial advisor entered it, the required confirmation letter was sent to the customer.

However, due to a coding error in the fourth quarter 2013 system change, when the supervisor approved the investment objective change on a day other than the same day the financial advisor entered the change for the customer's account, the system did not generate and send a confirmation letter. As a result, MSSB's system failed to generate and send approximately 23,500 investment objective change letters to customers. In most cases, MSSB reflected investment objectives on customers' monthly account statements. For customers that opted not to receive monthly account statements, the investment objective changes were not confirmed to customers in a timely manner.

Separately, if an investment objective change was entered but not approved within 29 days, the system automatically rejected the proposed change. In such circumstance, a customer's investment objective would not be changed and no investment change confirmation letter was sent. Where the proposed change was automatically rejected, the Firm did not have an adequate notification system that brought the auto rejected change to a supervisor's or FA's attention for review and action to determine if the change was rejected in error.

By reason of the foregoing, MSSB failed to reasonably enforce its supervisory system and, as a result, failed to send and retain required investment objective change letters. As a result, MSSB violated Section 17(a)(1) and Exchange Act Rules 17a-3(a)(17)(i)(B)(3) and 17a-4(e)(5) promulgated thereunder as well as

FINRA Rules 4511 and 2010. The Firm also violated NASD Conduct Rule 3010 (for conduct occurring prior to December 1, 2014), FINRA Rule 3110 (for conduct occurring on or after December 1, 2014) and FINRA Rule 2010.

The Firm Failed to Send Investment Objective Change Letters as a Result of a Coding Error Related to Account Number Changes

In the period between at least June 2012 and June 2016, Respondent MSSB failed to send at least 4,000 letters to customers confirming changes in their investment objectives within 30 days of the change. Due to a system coding error, the MSSB system incorrectly viewed accounts undergoing account number changes (for example, in connection with a move from one branch to another) as closed and thus suppressed the transmittal of the investment objective change letters. While MSSB's systems contained the updated information, MSSB did not confirm investment objective changes through the confirmation letters it otherwise would have sent. As a result, MSSB failed to ensure that it met its obligations to confirm investment objective changes. This error went undetected until FINRA brought the matter to the Firm's attention.

By reason of the foregoing, MSSB failed to reasonably enforce its supervisory system and, as a result, failed to send and retain the required investment objective change letters. As a result, MSSB violated Section 17(a)(1) and Exchange Act Rules 17a-3(a)(17)(i)(B)(3) and 17a-4(e)(5) promulgated thereunder as well as FINRA Rule 4511 and 2010. The Firm also violated NASD Conduct Rule 3010 (for conduct occurring prior to December 1, 2014), FINRA Rule 3110 (for conduct occurring on or after December 1, 2014) and FINRA Rule 2010.

OTHER FACTORS

In resolving this matter, FINRA has recognized MSSB's extraordinary cooperation in having (1) initiated, prior to detection or intervention by a regulator, an investigation to identify the scope and extent of its prospectus delivery and related supervisory failures; (2) made a rescission offer to thousands of customers who did not receive prospectuses via the View Prospectus Hyperlink and fulfilled qualifying offers; (3) retained an outside consultant to conduct a comprehensive review of the Firm's rescission offers and prospectus delivery fulfillment system and (4) provided substantial assistance to FINRA in its investigation. MSSB's remedial steps resulted in a reduced fine with respect to the prospectus delivery-related violations.

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

- Censure; and
- A fine of \$1,500,000

Respondent agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Respondent has submitted an Election of Payment form showing the method by which Respondent proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim that Respondent is unable to pay, now or at any time hereafter, the monetary sanctions 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 Respondent; and

C. If accepted:

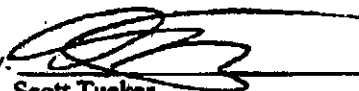
1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against me;
2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
3. FINRA may make 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 Respondent'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. Respondent 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.

Respondent Morgan Stanley Smith Barney

11/18/2016
Date (mm/dd/yyyy)

By: 
Scott Tucker
Global Head of Litigation

Reviewed by:



George S. Canellos
Counsel for Respondent
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Accepted by FINRA:

December 1, 2016

Date

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



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