

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND
CONSENT NO. 2019063917801**

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

RE: Morgan Stanley Smith Barney LLC, Respondent
Member Firm
CRD No. 149777

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

Morgan Stanley has been a FINRA member firm since May 2009. The Firm was created through the merger of the Global Wealth Management Group of Morgan Stanley & Co. LLC (CRD No. 8209) and the Smith Barney Division of Citigroup Global Markets Inc. (CRD No. 7059) into a joint venture. Morgan Stanley is headquartered in Purchase, New York. Morgan Stanley has more than 23,000 registered individuals and approximately 730 branch offices.

RELEVANT DISCIPLINARY HISTORY

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

OVERVIEW

From January 2012 through December 2017 (the "Relevant Period"), Morgan Stanley failed to reasonably supervise a registered representative who recommended short-term trades of corporate bonds and preferred securities in the accounts of ten customers in

violation of NASD Rule 3010 (for conduct before December 1, 2014), FINRA Rule 3110 (for conduct on or after December 1, 2014), and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

FINRA Rule 2111 requires member firms or their associated persons to have a reasonable basis to believe that a recommended securities transaction or investment strategy is suitable for the customer, based on information obtained through the reasonable diligence of the firm or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, investment objectives, investment experience, investment time horizon, liquidity needs, and risk tolerance. A firm's or associated person's reasonable diligence must provide the firm or associated person with an understanding of the potential risks and rewards associated with the recommended security or investment strategy.

FINRA Rule 3110 and its predecessor, NASD Rule 3010, require that each member firm take reasonable steps to ensure that the activities of each associated person comply with applicable securities laws and regulations, investigate red flags of potential misconduct, and take appropriate action when misconduct has occurred. A violation of FINRA Rule 3110 or NASD Rule 3010 also constitutes a violation of FINRA Rule 2010.

Morgan Stanley failed to reasonably supervise a registered representative, KG, because the Firm failed to take reasonable steps to review KG's recommended short-term trades of corporate bonds and preferred securities in the accounts of ten customers.¹ Specifically, on hundreds of occasions during the Relevant Period, KG recommended that the customers buy, and then promptly sell, corporate bonds or preferred securities, which due to their upfront sales charges, were typically only suitable for customers if held long-term.

For example, on or around September 18, 2013, KG recommended that a customer (the "Customer") purchase \$65,000 in corporate bonds issued by an insurance company. Fewer than two months later, on or about November 11, 2013, KG recommended that the Customer sell the bonds, at a loss, and use the proceeds to purchase \$63,800 in bonds issued by a bank. Approximately four months later, KG recommended that the Customer sell those bonds, also at a loss, and use the proceeds to purchase \$61,200 in bonds issued by a telecommunications company. KG recommended that the Customer sell a portion of those bonds on or about June 9, 2014, at a loss and after holding them for fewer than three months. Collectively, those recommended securities transactions required the Customer to pay more than \$5,500 in sales charges and resulted in more than \$2,500 in net losses, which were inclusive of sales charges paid by the Customer, minus any interest payments received by the Customer.

¹ FINRA has barred KG from associating with any FINRA member firm for failing to appear for on-the-record testimony requested pursuant to FINRA Rule 8210 in connection with FINRA's investigation into those recommendations.

During the Relevant Period, Morgan Stanley used a number of automated alerts to identify trading activity and accounts that warranted further review by a supervisor, including alerts that identified accounts in which the trading exceeded certain turnover and cost-to-equity ratios. From January 2012 to December 2014, KG's trading in the accounts of the ten affected customers generated nearly 100 alerts reflecting that the trading in these accounts exceeded the Firm's thresholds for potentially excessive turnover and cost-to-equity ratios.

In response to the alerts, Morgan Stanley failed to take reasonable steps to review red flags and understand the potential risks and rewards associated with KG's recommendations or to determine whether those recommendations were suitable. Instead, from January 2012 through September 2014, Morgan Stanley discussed the alerts with KG and contacted the affected customers to confirm whether they were satisfied with KG and his recommendations.

In September 2014, Morgan Stanley's central compliance department conducted a review of KG's securities recommendations, which concluded that his recommendations were "generating high costs/commissions and the products/investment strategies were costing the clients more money than they are making the client." In spite of these findings, the Firm did not take sufficient action to address KG's trading in his customers' accounts. Indeed, the ten affected customer accounts continued to generate alerts for potentially excessive turnover and cost-to-equity ratios. For instance, in February 2015, the Customer's account generated another alert for its cost-to-equity ratio over the preceding 12 months. As a result of that alert, the branch manager and KG called the Customer together to discuss her account, but after the Customer confirmed that she was satisfied with the management of her account generally, KG continued to recommend short-term trades of corporate bonds and Morgan Stanley did not take reasonable steps to review whether such recommended trades were suitable.

Ultimately, in January 2016, the Firm instructed KG to stop short-term trading in corporate bonds and preferred securities in all of his customer accounts. Nonetheless, KG recommended a small number of short-term trades in some of his customers' accounts between June 2016 and December 2017.

Collectively, KG's trading in the accounts of the ten affected customers caused the customers to suffer losses of more than \$900,000.²

As a result of the foregoing, Morgan Stanley violated NASD Rule 3010 (for conduct before December 1, 2014), FINRA Rule 3110 (for conduct on and after December 1, 2014), and FINRA Rule 2010.

² This AWC requires Morgan Stanley to pay restitution to eight of the ten affected customers, as the other two affected customers previously settled with Morgan Stanley separately.

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

- a censure;
- a fine of \$175,000; and
- restitution to the customers listed on Attachment A, in the total amount of \$774,574.08, plus interest as described further below.

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 it proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

Restitution is ordered to be paid to the customers listed on Attachment A hereto in the total amount of \$774,574.08, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from December 31, 2017 until the date this AWC is accepted by the National Adjudicatory Council (NAC).

A registered principal on behalf of Respondent Firm shall submit satisfactory proof of payment of restitution and pre-judgment interest (separately specifying the date and amount of each paid to each customer listed on Attachment A) or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted by email to EnforcementNotice@FINRA.org from a work-related account of the registered principal of Respondent Firm. The email must identify the Respondent and the case number and include a copy of the check, money order or other method of payment. This proof shall be provided by email to EnforcementNotice@FINRA.org no later than 120 days after acceptance of the AWC.

If for any reason Respondent cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, Respondent shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Respondent shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 calendar days of forwarding the undistributed restitution and interest to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

Restitution payments to customers shall be preceded or accompanied by a letter, not unacceptable to FINRA staff, describing the reason for the payment and the fact that the payment is being made pursuant to a settlement with FINRA and as a term of this AWC.

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 action brought by FINRA or any other regulator against Respondent;
 - 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 Respondent 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 the AWC's 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 it to submit it.

Morgan Stanley Smith Barney LLC
Respondent

July 30, 2020

Date

By: S. Anthony Taggart
Print Name: S. Anthony Taggart
Title: Managing Director & Counsel

Reviewed by:

W. Briendel
William D. Briendel
Counsel for Respondent
Greenberg Traurig LLP
200 Park Ave.
New York, NY 10166

Accepted by FINRA:
August 12, 2020

Date

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

Gabrielle Hirz
Gabrielle Hirz
Principal Counsel
FINRA
Department of Enforcement
99 High St., 9th Floor
Boston, MA 02110

ATTACHMENT A

**LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2019063917801**

<u>Customer Initials</u>	<u>Restitution Amount¹</u>
Customer 1	\$215,033.49
Customer 2	\$158,075.99
Customer 3	\$99,668.53
Customer 4	\$96,937.42
Customer 5	\$83,747.03
Customer 6	\$57,056.70
Customer 7	\$43,020.52
Customer 8	\$21,034.40

¹ Restitution amounts do not include interest, which is to be calculated at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from December 31, 2017 until the date this AWC is accepted by the NAC.