

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2021069330101**

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, Respondent Morgan Stanley & Co LLC 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 in this AWC.

I.

ACCEPTANCE AND CONSENT

- A. Respondent accepts and consents to the following findings by FINRA without admitting or denying them:

BACKGROUND

Morgan Stanley has been a FINRA member since 1970. Headquartered in New York, New York, the firm has approximately 4,200 registered representatives and approximately 40 branch offices. The firm provides services to corporate and broker-dealer customers and institutional investors, and acts as a broker-dealer, providing market access and execution services to market participants for a wide variety of products.

In June and August 2018, Morgan Stanley consented to nine settlements with eight exchanges and FINRA for violations of Section 15(c)(3) of the Securities Exchange Act of 1934, Exchange Act Rule 15c3-5, and with respect to the FINRA settlement, FINRA Rules 3110 and 2010.¹ For those violations, the firm was censured, fined \$1,100,000, and required to remediate the market access rule deficiencies described in the settlements and to implement controls and procedures reasonably designed to achieve compliance with the rules and regulations.

OVERVIEW

From August 2019 through June 2023, Morgan Stanley failed to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial risks of its market access business activity, including

¹ For more information about the firm, including prior regulatory events, visit BrokerCheck® at www.finra.org/brokercheck.

controls designed to prevent the entry of erroneous orders, in violation of Section 15(c)(3) of the Exchange Act, Exchange Act Rules 15c3-5(b) and 15c3-5(c)(1)(ii), and FINRA Rules 3110(a) and (b), and 2010.

From August 2019 through June 2023, the firm failed to conduct reasonable reviews of the effectiveness of certain of its market access controls and supervisory procedures, in violation of Exchange Act Rule 15c3-5(e)(1) and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

This matter originated from a FINRA examination of the firm's compliance with Section 15(c)(3) of the Exchange Act and Exchange Act Rule 15c3-5, commonly referred to as the market access rule.

Section 15(c)(3) of the Securities Exchange Act of 1934 prohibits broker-dealers from contravening the rules and regulations prescribed by the Securities and Exchange Commission to "provide safeguards with respect to the financial responsibility and related practices of brokers and dealers." The SEC adopted Exchange Act Rule 15c3-5 to reduce the risks associated with market access faced by broker-dealers, the securities markets, and the financial system as a whole, and thereby enhance market integrity and investor protection by requiring effective financial and regulatory risk management controls reasonably designed to limit financial exposure and ensure compliance with applicable regulatory requirements to be implemented on a market-wide basis.

Rule 15c3-5(b) requires a broker or dealer with market access or that provides a customer or any other person with access to an exchange or alternative trading system through use of its market participant identifier or otherwise to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity.

Exchange Act Rule 15c3-5(c)(1)(ii) requires a broker-dealer with market access to establish, document, and maintain financial risk management controls and supervisory procedures that are reasonably designed to prevent the entry of erroneous orders by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders.

Rule 15c3-5(e) requires a broker-dealer with market access to establish, document, and maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures relating to market access. Subsection (e)(1) requires the broker-dealer to conduct and document a review of its market access business at least annually in accordance with written procedures, and subsection (e)(2) requires the CEO to certify annually that the broker-dealer conducted the review and is in compliance with the Rule.

FINRA Rule 3110(a) requires firms to establish and maintain a supervisory system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws, regulations, and FINRA rules. FINRA Rule

3110(b) requires firms to establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

Violations of Exchange Act § 15(c)(3), Exchange Act Rule 15c3-5, and FINRA Rule 3110 are also violations of FINRA Rule 2010, which requires members, in the conduct of their business, to observe high standards of commercial honor and just and equitable principles of trade.

At all relevant times, Morgan Stanley was a broker-dealer with direct market access and was required to comply with Exchange Act Rule 15c3-5.

Morgan Stanley failed to establish, document, and maintain risk management controls and supervisory procedures reasonably designed to manage the risks associated with its market access activity and to prevent the entry of erroneous orders.

Morgan Stanley sends certain orders to the market via “low touch” or “high touch” order handling. Low touch orders are handled in an agency capacity and flow electronically through the firm’s trading infrastructure to the market without handling or other interaction by firm traders. The firm applies pre-trade controls to low touch orders before they are routed to an exchange or alternative trading system (ATS). The firm determines pre-trade controls on a customer-by-customer basis.

High touch orders, by contrast, are not routed automatically without trader interaction. Instead, a trader receives a customer order and manually handles the order, entering it into the firm’s order management system. The firm trader may choose to execute such orders on an agency, principal, or riskless principal basis, or a combination of these. The trader determines how to handle the order on a case-by-case basis, based on factors such as customer instructions, trader discretion, and market factors. In contrast to low touch orders and reflecting that a trader (rather than each applicable customer) makes market access trading decisions for such high-touch orders, the firm determines certain pre-trade controls for high touch orders based upon the trader accessing the market for the order, rather than the customer. After the firm applies the pre-trade risk controls, the trader routes the orders to an exchange, ATS, or another broker-dealer.

From August 2019 through June 2023, Morgan Stanley did not maintain a system of controls reasonably designed to manage the risks of certain of its market access activity with respect to certain of its low touch and high touch customers as described in further detail below.

When onboarding new customers placing low touch orders, the firm placed those customers into groups, which determined the order controls that would apply to each customer. However, the firm’s procedures did not describe the process for placing new clients into client groups or how the firm determined which group to place customers

into. Further, the firm's procedures did not describe the process for establishing reasonable thresholds for orders priced more than a specified percentage away from a specified reference price (the "price away" control) or orders exceeding a pre-established maximum dollar amount for a single order (the "single order notional value" control) for the different customer groups. Further, the firm did not document on a customer-by-customer basis its rationale for why those thresholds were reasonable for each customer.

With respect to high touch customers, the firm assigned single order notional value thresholds to traders on the desk, rather than by customer group as it did for low touch customers, reflecting the fact that each trader determines how to access the market. The firm rated traders in a low, medium, or high category based on each trader's experience, which in turn determined the thresholds applied to high touch orders. The firm's procedures did not document the rationale for why the limits were reasonable. In addition, the firm applied a standardized single order notional value threshold for high touch traders on one specific trading desk without a documented rationale, which permitted all traders on that desk to submit orders for up to the threshold without regard for the traders' ratings or other characteristics.

In addition, the firm had a standardized market impact limit (MIL) control, which is one type of duplicative order control, for low touch customers (a) that entered orders through a particular platform and (b) did not use software that offered high speed direct market access to latency-sensitive customers. The firm did not provide any documented rationale or analysis justifying the standardized MIL control, which did not account for several hundred unique customers' trading patterns or order history, including customers who manually entered orders.

Moreover, the firm had no documented rationales for price away controls that exceeded exchange guidelines for clearly erroneous transactions for low touch customers provided with direct market access through the third-party, high-speed software. The firm's customers that use software are some of the firm's larger customers and submit a higher volume of orders to the market faster than other customers. Therefore, an erroneous order from these customers had greater potential to impact the market.

From August 2019 through June 2023, Morgan Stanley's market access controls applied soft blocks, or "hold limits," to transactions that breached its risk management thresholds. In contrast to a hard block, which prevents an order that triggers a credit, price, or size control parameter from being routed to a market center by automatically rejecting it, a hold limit pauses the order for review, after which the reviewer may release or reject the order. The firm's procedures required that firm personnel review each paused order but did not require the personnel responsible for reviewing hold limit alerts to contemporaneously document the rationale for releasing the subject orders into the market after completion of the review process. The firm also had a system that permitted orders that had been manually reviewed and released and subsequently amended at a later time to be more conservative than the original order to be released without additional manual review. Such release without additional review was unreasonable to prevent the entry of erroneous orders.

The firm remediated the issues described above by June 2023.

By failing to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial risks of its market access business activity, Morgan Stanley violated Exchange Act § 15(c)(3), Exchange Act Rules 15c3-5(b) and 15c3-5(c)(1)(ii), and FINRA Rules 3110(a) and (b), and 2010.

Morgan Stanley failed to perform reasonable regular reviews of the effectiveness of the firm's risk management controls and supervisory procedures.

The firm's procedures provided that "[t]he [f]irm will periodically, but no less than annually, reassess its systems of financial and regulatory risk management controls . . . to ensure that its controls continue to satisfy the requirements of the Market Access Rule." Nonetheless, from August 2019 through June 2023, the firm did not in certain circumstances establish, document, and maintain a reasonable system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures relating to market access pursuant to Rule 15c3-5(e)(1). The firm's procedures did not require a review for single order notional value thresholds based on customers' order activity but, rather, only did so when single order threshold limits exceeded the maximum guidelines set by the firm. However, those guidelines were set at high levels and thus would not adequately identify individual customers with potentially unreasonable limits. With respect to the high touch traders, the firm relied on meetings with the head trader to assess the reasonableness of thresholds applied to those traders but did not have any documentation of those meetings containing rationales for thresholds applied to low, medium, or high categories or why those categories were reasonable. The firm also failed to assess the reasonableness of pre-trade MIL control thresholds, and the firm's post-trade MIL reviews, due to an oversight, did not include MIL breaches by customers that submitted orders through the third-party, high-speed, software.

The firm remediated the issues described above by June 2023.

By failing to conduct reasonable reviews of the effectiveness of its market access controls and supervisory procedures, Morgan Stanley violated § 15(c)(3) of the Exchange Act, Exchange Act Rule 15c3-5(e), and FINRA Rules 3110(a) and (b), and 2010.

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

- a censure and
- a \$1,000,000 fine.

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 an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

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 its acceptance or rejection.

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 its subject matter 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 right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party. Nothing in this provision affects Respondent's testimonial obligations in any litigation or other legal proceedings.
- 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.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's 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 Respondent 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 in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

November 1, 2024

Date

Samantha Schreiber

Morgan Stanley & Co. LLC
Respondent

Print Name: Samantha Schreiber



Title: Authorized Signatory

Accepted by FINRA:

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

November 1, 2024
Date

Alexa Perlman
Alexa Perlman
Counsel
FINRA
Department of Enforcement
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