

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the
Continued Membership
of
Morgan Stanley Smith Barney, LLC

Notice Pursuant to
Rule 19h-1 of the
Securities Exchange Act
of 1934

SD-2147

Date: November 28, 2017

I. Introduction

On February 8, 2017, Morgan Stanley Smith Barney, LLC¹ (“MSSB” or the “Firm”) submitted a Membership Continuance Application (“MC-400A” or “Application”) with FINRA’s Department of Registration and Disclosure.² The Application seeks to permit the Firm, a FINRA member subject to statutory disqualification, to continue its membership with FINRA notwithstanding its disqualification. A hearing was not held in this matter. Rather, pursuant to FINRA Rule 9523(b), FINRA’s Department of Member Regulation (“Member Regulation”) approves the Firm’s Application and is filing this Notice pursuant to Rule 19h-1 of the Securities Exchange Act of 1934 (“Exchange Act”).

II. The Statutorily Disqualifying Event

MSSB is subject to statutory disqualification pursuant to Section 3(a)(39)(F), incorporating by reference Section 15(b)(4)(D), of the Exchange Act as a result of an Order Instituting Administrative and Cease-And-Desist Proceedings issued by the United States Securities and Exchange Commission (“SEC” or the “Commission”) on January 13, 2017 (the “SEC Order”).³

¹ On January 13, 2009, Morgan Stanley and Citigroup announced that Citigroup would sell 51% of Smith Barney to Morgan Stanley, creating Morgan Stanley Smith Barney, which was formerly a division of Citi Global Wealth Management. Further, on September 25, 2012, Morgan Stanley announced that its U.S. wealth management business was renamed “Morgan Stanley Wealth Management.” The broker-dealer designation for Morgan Stanley Wealth Management remained “Morgan Stanley Smith Barney LLC.”

² See the MC-400A Application and related exhibits (attached as Exhibit 1).

³ See SEC Order, *In the Matter of Morgan Stanley Smith Barney, LLC*, SEC Admin Proc. File No. 3-17773, dated January 13, 2017 (attached as Exhibit 2).

The SEC found that from 2002 through 2016, MSSB and its predecessor Morgan Stanley, overcharged more than 149,000 advisory clients accounts a total of \$16,169,215 in advisory fees. There were 36 different categories of errors that resulted in the overcharges. Of the 36 categories, 30 originated with Morgan Stanley or MSSB. The SEC found that MSSB willfully violated various sections of the Advisers Act because it failed to comply with requirements regarding annual surprise custody examinations for the years 2011-2012; did not maintain certain client contracts; and failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Investment Advisers Act of 1940 (“the Advisers Act”).

The SEC Order required the Firm to cease and desist from committing or causing any violations and any future violations of Sections 204(a), 206(2) and 206(4) of the Advisers Act and Rules 204(a)(10), 204-2(e)(1), 206(4)-2 and 206(4)-7 promulgated thereunder. MSSB was also censured and ordered to pay a civil money penalty in the amount of \$13,000,000. The Firm also agreed to comply with a number of undertakings, which will extend for three years from the date of the Order, and are related to fee billing, books and records undertakings and notice to advisory clients.⁴

III. Background Information

A. The Firm

MSSB is based in Purchase, New York and has been a FINRA (f/k/a NASD) member since May 2009.⁵ The Firm has approximately 763 branch offices; 586 Offices of Supervisory Jurisdiction (“OSJ”), and the Firm employs approximately 1,304 registered principals, 23,313 registered representatives and 26,045 employees. The Firm currently employs 16 statutorily disqualified individuals.⁶

⁴ See Exhibit 2 at pp. 324- 327.

⁵ See Exhibit 1 at p. 335.

⁶ See list of statutorily disqualified individuals associated with MSSB, extracted from the records of the Central Registration Depository (“CRD”) (attached as Exhibit 3). The statutorily disqualified individuals associated with the Firm are Robert Anthony Biernat, Florencio Otto Busot (“Busot”), John William Corbett, III, Neil A. Fox, William J. Goebelbecker; Joel L. Halpern (“Halpern”), John W. Kelsey, George A. Mayer, Jesse E. Mclain, Jr., Nina B. Nitti, David A. Pendelton, Gary N. Shaw, Timothy M. Stevens, Charles W. Tomasheski, Sheldon J. Wilshinsky and John D. Yeazel. The Firm was only required to file MC-400 Applications on behalf of Busot and Halpern. In the case of both individuals they are subject to disqualification due to willful violations of the federal securities laws, however, both were approved to associate with the Firm in the non-prohibited capacities. MC-400 Applications on behalf of the other individuals were not required, because the sanctions from their disqualifying events were either no longer in effect when they associated with MSSB or did not trigger the need for a statutory disqualification review, as outlined in *FINRA Regulatory Notice 09-19* (April 2009).

MSSB is approved to engage in the following lines of businesses:⁷ broker or dealer making inter-dealer markets in corporation securities over the counter; broker or dealer retailing corporate equity securities over the counter; broker or dealer selling corporate debt securities; underwriter or selling group participant in corporate securities other than mutual funds; mutual fund underwrite or sponsor; mutual fund retailer; U.S. government securities dealer; U.S. government securities broker; municipal securities dealer; municipal securities broker; put and call broker or dealer or option writer; investment advisory services; broker or dealer selling variable life insurance or annuities; solicitor of time deposits in an financial institution; broker or dealer selling gas or oil interests; broker or dealer selling securities of non-profit organizations; non-exchange member arranging for transactions in listed securities by exchange member; broker or dealer involved in a networking, kiosk, or similar arrangement with a bank, savings bank or association, or credit union; effects transactions in commodity futures, commodities, commodity options as broker or others or dealer for own account; trading securities for own account; private placement of securities; broker or dealer selling interest in mortgages or other receivables; acts as a broker or dealer engaging in underwriting municipal securities, repos and reverse-repos, offering on-line trading/electronic trading, engaging in selling securities futures products, and a broker or dealer selling interests in unregistered private investment funds; will conduct research and soft dollar activities, and provide mergers and acquisition advisory services.⁸ MSSB is a member of three other self-regulatory organizations (“SROs”): NASDAQ Stock Market, New York Stock Exchange (“NYSE”), NYSE American LLC and DTTC.⁹

B. FINRA Routine Examinations

MSSB is examined by FINRA on an annual basis. The Firm’s 2016 Cycle Examination (the “2016 examination”) resulted in a cautionary action.¹⁰ The Firm was cited for the following three exceptions: 1) the Firm failed to keep current information in the Uniform Application for Securities Industry Registration or Transfer, Form U4 (“Form U4”) sections titled “located at” and “supervised from” for 21 of 22 sampled employees (see FINRA By-Laws Article V Section 2); 2) a review of a registered representative’s Form U4 filings revealed that the representative failed to update his Form U4, within 30 days as required by FINRA By-Laws, for five disclosable events (FINRA By-Laws Article V, Section 2); and 3) with respect to the agreements covering both the clearance and custody of customer securities, with Bank of New York, there

⁷ See extract from CRD, Types of Business for MSSB (attached as Exhibit 4).

⁸The Firm engages in other non-securities business including transactions in foreign exchange, precious metals, certificates of deposits, and non-securities based futures. The Firm also engages in non-client facing hedging in non-securities products which is incidental to its trading business.

⁹See *id.*

¹⁰See FINRA’s Disposition Letter, dated June 29, 2017, and Report of Examination of No. 20160477355, dated May 18, 2017 (attached as Exhibit 5).

were areas within the agreement which were identified as being weak or needing to be revised (Securities Exchange Act of 1934 240.15c3-3(c)(5)).

FINRA's 2015 Cycle Examination (the "2015 examination") resulted in a referral to FINRA's Department of Enforcement for three exceptions:¹¹ 1) the Firm failing to establish and enforce its supervisory systems, which resulted in its failing to adequately supervise its employees' outside business activities ("OBAs") and private securities transactions in violation of FINRA Rule 3110 (a); 2) MSSB failed to establish and maintain a system of controls reasonably designed to validate changes of customers' investment objectives (FINRA Rule 3110 (a)); and 3) the Firm failed to comply with SEC Rule 204 Reg SHO in that it failed to timely resolve two out of a sample of 13 fail to deliver positions (SEC Regulation SHO 242.204). This referral is still pending with Enforcement. The Firm was also issued a Cautionary Action for four exceptions:¹² 1) failure to establish and enforce a system of controls to supervise its customers' use of proceeds from non-purpose loans (FINRA Rule 3110 (a); 2) MSSB failed to adequately enforce its policy that a designated supervisor approve all employee restricted securities transactions (FINRA Rule 3110 (b)); 3) a review of the Firm's Alternative Investment Products maintained in its clients' IRA accounts for which the Firm was required to act as custodian disclosed that the Firm did not obtain the proper no-lien letters from the Limited Partnerships (FINRA Rule 4510 & SEA Rule 240.15c3-3); and 4) an agreement with the Bank of New York contained contradictory language which may have led to customers' securities in the custody accounts not being properly protected (SEA Rule 240.15c3-3(c)(5)).

C. Regulatory Actions

Since 2015, apart from the SEC Order, MSSB has been the subject of 23 settled disciplinary matters. Seventeen of these matters involve Letters of Acceptance, Waiver and Consent ("AWCs") with FINRA, three additional SEC regulatory actions, two consent orders issued by state regulators, and an AWC accepted by another SRO.

¹¹ See FINRA's Disposition Letter, dated September 19, 2016, and Report of Examination No. 20150431958 dated June 13, 2016 (attached as Exhibit 6).

¹² See *id.*

1. FINRA Disciplinary Actions

Since 2015, MSSB has executed 17 AWCs¹³ to resolve FINRA disciplinary actions. Collectively, these AWCs addressed misconduct concerning: failure to establish and maintain a supervisory system and written supervisory procedures to prevent and detect unsuitable short-term trading of Unit Investment Trusts; market regulation violations; purchasing municipal securities for its own account at prices that were not fair or reasonable; failure to send a total of approximately four million margin disclosures during 2012, 2013 and 2014; failure to deliver prospectuses and failure to implement a reasonable supervisory system ensuring delivery of prospectuses; failure to comply with Reg SHO requirements; failure to report accurate reportable positions to the Large Options Position Reporting system (“LOPR”); failure to timely report transactions to TRACE; failure to implement anti-money laundering procedures to detect fraud; accepting new issues prior to the commencement of trading in the secondary market for those new issues; failure to accurately report market orders; failure to comply with OATS reporting requirements; approving deposits of checks without obtaining a Letter of Authorization; failure to establish WSPs regarding outgoing wire transfers and branch check disbursements; trading reporting and order marking deficiencies; and failure to have adequate procedures to address short positions in tax-exempt municipal bonds. The Firm was censured in all of the matters and was ordered to pay fines ranging from \$7,500 to \$3,250,000 and in certain cases, ordered to pay restitution to customers and comply with undertakings to revise its WSPs.

2. SEC and Other Regulatory Actions

Aside from the disqualifying event, MSSB has been subject to three additional SEC orders within the past two years, with fines ranging from \$1,000,000 to \$8,000,000. Those three instances were from June 2016 (“2016 Order”), January 2017 (“January 2017 Order”) and February 2017 (“February 2017 Order”). In the 2016 Order, the SEC found that MSSB willfully violated Rule 30(a) of Regulation S-P because it failed to adopt written policies and procedures, as required by the Safeguards Rule, to protect customer records and data.¹⁴ In this matter, MSSB was censured and fined \$1,000,000. In the January 2017 Order, the SEC found that the Firm violated Section 17(a)(2) of the Securities Act, which prohibits any person in the offer or sale of

¹³ See 17 AWCs executed by MSSB since 2015. Included are AWC No. 2016049857301, dated November 17, 2017; AWC No. 2016048805501, dated September 25, 2017; AWC No. 20120347147-01, dated August 22, 2017; AWC No. 2014040289101, dated February 15, 2017; AWC No. 2014042651801, dated December 1, 2016; AWC No. 2013037025101, dated November 17, 2016; AWC No. 2015044100801, dated October 17, 2016; AWC No. 2014043135901, dated October 17, 2016; AWC No. 2011029749101, dated June 22, 2016; AWC No. 2013037921701, dated February 29, 2016; AWC No. 2012034142201, dated February 25, 2016; AWC No. 2014041399601, dated December 16, 2015; AWC No. 2011030674102, dated August 14, 2015; AWC No. 2012033446701, dated June 9, 2015; AWC No. 2011025479301, dated June 19, 2015; AWC No. 2011028182701, dated May 13, 2015; and AWC No. 2013038306401, dated April 1, 2015 (collectively attached as Exhibit 7).

¹⁴ See SEC Order *In the Matter of Morgan Stanley Smith Barney, LLC*, SEC Admin Proc. File No. 3-17280, dated June 8, 2016 (attach as Exhibit 8). The 2016 Order does subject the Firm to a statutory disqualification; however, the Firm was not required to file a Membership Continuance Application because the sanctions from the 2016 Order are no longer in effect.

a security from obtaining money or property by means of any untrue statement or any omission of a material fact in order to make the statements made not misleading.¹⁵ The Firm was ordered to pay disgorgement of \$624,458.27, prejudgment interest of \$89,277.34 and a civil money penalty in the amount of \$2,250,000. In the February 2017 Order,¹⁶ the Commission found that the Firm willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 because it failed to adopt and implement written policies and procedures to prevent such violations of the Advisers Act. MSSB was censured and fined \$8,000,000.

Since 2015, the Firm resolved two regulatory actions with state securities regulators and one regulatory action with another SRO.

In April 2017, the Massachusetts Securities Division issued a consent order¹⁷ (“Massachusetts Order”) against MSSB alleging that between September 1, 2013 and April 30, 2015, MSSB engaged in unethical conduct in connection with sales contests designed to market banking and lending products to its wealth management clients. The Division found that the Firm failed to observe high stands of commercial honor and just and equitable principles of trade in the conduct of its business as required by 950 Mass. Code Regs. 12.204(1)(a), resulting in a violation of Section 204(a)(2)(B) of Massachusetts General Law. The Firm was censured, fined \$1,000,000 and ordered to provide a written report to the Division, within 120 days of the Massachusetts Order, identifying enhancements to its policies and procedures.¹⁸

In August 2016, the Mississippi Securities Division issued a Consent Order¹⁹ (“Mississippi Order”) against the Firm for its failure to reasonably supervise certain of its agents in a Mississippi branch office and failure to enforce supervisory procedures to comply with the Securities Division requirements.²⁰ The Firm was ordered to pay an administrative fine in the

¹⁵ See SEC Order *In the Matter of Morgan Stanley Smith Barney, LLC*, SEC Admin Proc. File No. 3-17809, dated January 24, 2017 (attach as Exhibit 9). The January 2017 Order does not subject the Firm to a statutory disqualification, as there were no findings that MSSB willfully violated the federal securities laws.

¹⁶ See SEC Order *In the Matter of Morgan Stanley Smith Barney, LLC*, SEC Admin Proc. File No. 3-17845, dated February 14, 2017 (attach as Exhibit 10). The SEC’s Order does subject the Firm to a statutory disqualification; however, the Firm was not required to file a Membership Continuance Application because the sanctions from the February 2017 Order are no longer in effect.

¹⁷ See the Consent Order issued by the Massachusetts Securities Division, *In the Matter of Morgan Stanley Smith Barney, LLC*, Docket No. E-2016-0055, dated April 7, 2017 (attached as Exhibit 11).

¹⁸ The Massachusetts Order does not subject the Firm to a statutory disqualification because there were no findings of violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct and the Firm was not barred by the state regulator.

¹⁹ See the Consent Order issued by the Mississippi Securities Division, *In the Matter of Morgan Stanley Smith Barney, LLC*, Administrative Proceeding No. LS-12-0454, dated August 8, 2016 (attached as Exhibit 12).

²⁰ The Mississippi Order does not subject the Firm to a statutory disqualification because there were no findings of violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct and the Firm was not barred by the state regulator.

amount of \$100,000 and was assessed costs and expenses incurred with the investigation in the amount of \$400,000.

In September 2016, the Firm consented to an AWC with the NYSE MKT LLC.²¹ NYSE MKT LLC concluded that during periods between September 27, 2010 and January 2016, MSSB had inaccurately reported positions to the LOPR system and had supervisory deficiencies related to these matters. The Firm was censured, fined a total of \$2,200,000, of which \$1,650,000 was to be paid as a breakdown of \$825,000 for the LOPR violations and \$825,000 for supervisory deficiencies.

IV. The Firm's Proposed Continued Membership with FINRA and Plan of Supervision

MSSB seeks to continue its membership with FINRA notwithstanding its status as a disqualified member.

To supplement the actions already taken by the Firm, MSSB has agreed to the following Plan of Supervision as a condition of its continued membership with FINRA:²²

1. Comply with the undertakings specified in the SEC Order;
2. Provide Member Regulation with copies of correspondence between the Firm and Commission staff regarding any request to extend the procedural dates relating to the undertakings in the SEC Order;
3. Provide Member Regulation with a copy of the certification and all supporting documentation that will be provided to the Commission upon completion of the undertakings as specified in the SEC Order;
4. All requested documents and certifications under this Plan of Supervision shall be sent directly to:

Lorraine Lee-Stepney
Manager, Statutory Disqualification Program
FINRA
1735 K Street NW
Washington, DC 20006
Lorraine.Lee@finra.org.

V. Discussion

After carefully reviewing the record in this matter, Member Regulation approves the Firm's request to continue its membership with FINRA, subject to the terms and conditions set forth herein.

²¹ See NYSE MKT LLC AWC No. 20150441008, dated September 20, 2016 (attached as Exhibit 13).

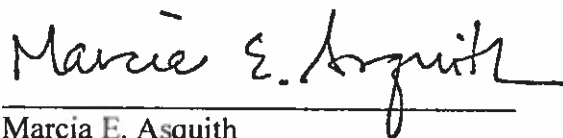
²² See executed copy of the Plan of Supervision dated October 23, 2017 (attached as Exhibit 14).

In evaluating MSSB's Application, Member Regulation assessed whether the Firm has, as of the date of this notice, demonstrated that its continued membership is consistent with the public interest and does not create an unreasonable risk of harm to investors or the markets. Typically, factors that bear on Member Regulation's assessment include the nature and gravity of the statutorily disqualifying misconduct, the time elapsed since its occurrence, restrictions imposed on the Firm, the Firm's regulatory history, and whether there has been any intervening misconduct.

As of the date of this Notice, the Firm represents that it continues to comply with the terms of the Order.²³ When combined with the proposed Plan of Heightened Supervision, the Firm's continued membership in FINRA is consistent with the public interest and does not create an unreasonable risk of harm. While the SEC Order at issue involves serious violations of the federal securities laws, the undertakings contained therein address necessary changes to the Firm's procedures and compliance function and are reasonably designed to prevent and deter similar misconduct in the future. In addition, Member Regulation conducted a review of the Firm's regulatory history and recent disciplinary actions and finds that none of these matters should prevent the continuance of the Firm as a FINRA member.

FINRA is satisfied, based on the foregoing and on the Firm's representations made pursuant to the Plan of Heightened Supervision that the Firm's continued membership with FINRA does not create an unreasonable risk of harm to the market or investors. Accordingly, Member Regulation approves MSSB's Application to continue its membership with FINRA. The Firm is also registered with NASDAQ Stock Market, NYSE and NYSE American LLC.²⁴ In conformity with the provisions of Rule 19h-1 of the Exchange Act, the continued membership of the Firm will become effective within 30 days of the receipt of this notice by the Commission, unless otherwise notified by the SEC.

On Behalf of FINRA,



Marcia E. Asquith
Executive Vice President and Corporate Secretary

²³See letter from Elizabeth Marino of Sidley, Austin LLP (counsel for MSSB), to Lorraine Lee-Stepney, of FINRA, dated October 3, 2017, wherein an update is provided on the progress that MSSB has made on the undertakings (attached as Exhibit 15).

²⁴Based on DTCC records current as of November 24, 2017.

Exhibits

1. The MC-400A Application and related exhibits.
2. SEC Order, *In the Matter of Morgan Stanley Smith Barney, LLC*, SEC Admin Proc. File No. 3-17773, dated January 13, 2017.
3. List of statutorily disqualified individuals associated with MSSB, extracted from the internal systems of FINRA.
4. CRD, Types of Business for MSSB.
5. FINRA's Disposition Letter, dated June 29, 2017 and Report of Examination of No. 20160477355 dated May 18, 2017.
6. FINRA's Disposition Letter, dated September 19, 2016 and Report of Examination No. 20150431958 dated June 13, 2016.
7. AWCs executed by MSSB since 2015. Included are AWC No. 2016049857301, dated November 17, 2017; AWC No. 2016048805501, dated September 25, 2017; AWC No. 20120347147-01, dated August 22, 2017; AWC No. 2014040289101, dated February 15, 2017; AWC No. 2014042651801, dated December 1, 2016; AWC No. 2013037025101, dated November 17, 2016; AWC No. 2015044100801, dated October 17, 2016; AWC No. 2014043135901, dated October 17, 2016; AWC No. 2011029749101, dated June 22, 2016; AWC No. 2013037921701, dated February 29, 2016; AWC No. 2012034142201, dated February 25, 2016; AWC No. 2014041399601, dated December 16, 2015; AWC No. 2011030674102, dated August 14, 2015; AWC No. 2012033446701, dated June 9, 2015; AWC No. 2011025479301, dated June 19, 2015; AWC No. 2011028182701, dated May 13, 2015; and AWC No. 2013038306401, dated April 1, 2015.
8. SEC Order *In the Matter of Morgan Stanley Smith Barney, LLC*, SEC Admin Proc. File No. 3-17280, dated June 8, 2016.
9. SEC Order *In the Matter of Morgan Stanley Smith Barney, LLC*, SEC Admin Proc. File No. 3-17809, dated January 24, 2017.
10. SEC Order *In the Matter of Morgan Stanley Smith Barney, LLC*, SEC Admin Proc. File No. 3-17845, dated February 14, 2017.
11. Consent Order issued by the Massachusetts Securities Division, *In the Matter of Morgan Stanley Smith Barney, LLC*, Docket No. E-2016-0055, dated April 7, 2017.
12. Consent Order issued by the Mississippi Securities Division, *In the Matter of Morgan Stanley Smith Barney, LLC*, Administrative Proceeding No. LS-12-0454, dated August 8, 2016.
13. NYSE MKT LLC AWC No. 20150441008, dated September 20, 2016.

14. Executed copy of the Plan of Supervision dated October 23, 2017.

15. Letter from Elizabeth Marino of Sidley, Austin LLP (counsel for MSSB), to Lorraine Lee-Stepney, of FINRA, dated October 3, 2017.