FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2016048805501

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

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

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Morgan Stanley Smith Barney LLC ("Morgan Stanley," the "Firm" 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 the Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. Morgan Stanley 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 since May 2009. Morgan Stanley was formed by the combination of the Global Wealth Management Group of Morgan Stanley & Co., Inc. and the Smith Barney Division of Citigroup Global Markets, Inc. The Firm has approximately 23,600 registered individuals and 757 branch offices.

RELEVANT DISCIPLINARY HISTORY

Morgan Stanley has no relevant disciplinary history.

OVERVIEW

From January 2012 through June 2015 (the "Relevant Period"), Morgan Stanley failed to establish and maintain a supervisory system and written supervisory procedures reasonably designed to detect and prevent unsuitable short-term trading of Unit Investment Trusts. Based on the foregoing, Morgan Stanley violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

FACTS AND VIOLATIVE CONDUCT

1. Unit Investment Trusts

A Unit Investment Trust ("UIT") is a SEC-registered investment company that offers shares or "units" in a portfolio of securities in a public offering. Generally, a UIT's portfolio is not actively traded and follows a "buy-and-hold" strategy. A UIT terminates on a specified maturity date, often after 15 or 24 months, at which point the underlying securities are sold and the resulting proceeds are paid to the investors.

UITs impose a variety of sales charges. For example, during the Relevant Period, a typical 24-month UIT imposed: (1) an initial sales charge, which was 1% of the purchase price; and (2) a deferred sales charge, which was up to 2.5% of the offering price. Also, most UIT sponsors charged a creation and development fee ("C&D fee"), which was generally 0.5% of the offering price.[1] If the proceeds from a UIT sale were "rolled over" to a new UIT, UIT issuers often waived the initial sales charge, but the deferred sales charge and C&D fee still applied. The deferred sales charge and C&D fee typically were charged during months three through six of the UIT's duration. A registered representative who repeatedly recommended the sale of a customer's UIT position before the maturity date and rolled that investment into a new UIT would cause the customer to incur increased sale charges over time.

For example, a hypothetical customer who purchased a 24-month UIT and held it until maturity would have paid a sales charge of about 3.95%. However, if after six months, the customer rolled over the UIT into a new UIT, he or she would have paid an additional 2.95% in sales charges. And, if the customer repeatedly rolled over the existing UIT into a new UIT every six months, he or she would have paid total sales charges of approximately 12.8% over a two-year period.

Because of the long-term nature of UITs, their structure, and upfront costs, short-term trading of UITs may be improper and raises suitability concerns.

2. Morgan Stanley's UIT Business

During the Relevant Period, Morgan Stanley executed more than $33.4 billion in UIT transactions generating more than $650 million in sales credits and commissions. The $33.4 billion in UIT transactions included more than $5.2 billion in UIT transactions involving "early rollovers," defined by the Firm as UITs rolled over more than 100 days before maturity.

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[1] In addition to these charges, most UITs charge annual operating expenses that are paid to the sponsor out of the assets of the UIT.

3. Morgan Stanley Failed to Adequately Supervise the Sale of UITs

Morgan Stanley failed to adequately supervise representatives' sales of UITs in several respects. First, although the Firm's compliance procedures noted that "UITs are intended to be long-term investments," the Firm's procedures offered insufficient guidance to supervisors regarding how they should monitor and review UIT transactions to detect unsuitable short-term trading of UITs, including short-term rollovers. Also, during the Relevant Period, the Firm conducted no training for registered representatives specific to UITs.

Further, Morgan Stanley had an inadequate system to detect potentially unsuitable short-term UIT rollovers. During the Relevant Period, the Firm's order entry system alerted supervisors to short-term UIT "switches," which the Firm's procedures defined as the purchase of a UIT within 60 days of the sale of either an open-end mutual fund or UIT. When such a switch was identified, the Firm required that (1) the representative provide a justification for the switch, and (2) a supervisor review and approve the transaction prior to its execution. If the supervisor approved the transaction, the Firm inserted additional disclosure language on the trade confirmation notifying the customer that the switch could result in new sales charges. Further, certain UIT switch transactions appeared on Morgan Stanley's Multi-Product Switch Report, a surveillance report the Firm issued to supervisors as a tool to assist with the supervision of such transactions.

However, during the Relevant Period, the Firm excluded UIT rollovers from the definition of a "switch" in its policies and procedures. As a result, if a representative selected "rollover" as the justification for a UIT switch in the Firm's order entry system, UIT rollovers were not routed to supervisors for review and approval prior to execution. In addition, the Firm did not include disclosure language on trade confirmations for UIT rollovers.

Also, because the Firm excluded UIT rollovers from the definition of a "switch," UIT rollovers that otherwise would have appeared on the Firm's Multi-Product Switch Report were omitted from the Report. Therefore, during the Relevant Period, the Firm had no automated mechanism to detect short-term UIT rollovers.

During the Relevant Period, hundreds of Morgan Stanley representatives executed short-term UIT rollovers in thousands of customer accounts.

In June 2015, the Firm modified its policies and procedures to include UIT rollovers in the switch definition, thereby making UIT rollovers executed more than 100 days prior to maturity subject to the Firm's supervisory review and approval process.

Based on the foregoing, Morgan Stanley violated NASD Rule 3010 and FINRA Rules 3110 and 2010.[1]

OTHER FACTORS

In resolving this matter, FINRA has recognized Morgan Stanley's cooperation in having: (1) initiated, prior to intervention by a regulator, a firm-wide investigation to identify the scope of potentially unsuitable short-term UIT rollovers, which investigation included, among other things, the interview of more than 65 firm personnel and the retention of an outside consultant to conduct a statistical analysis of UIT rollovers at the Firm; (2) identified customers harmed by potentially unsuitable short-term UIT rollovers and established a plan to provide remediation to those customers; and (3) provided substantial assistance to FINRA in its investigation.

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

- a censure;
- a fine of $3.25 million; and
- restitution to 3,020 customer accounts in the amount of $9,786,964.88.

Restitution is ordered to be paid to the customers listed on Attachment A hereto in the total amount of $9,786.964.88, 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 June 1, 2015, until the date this AWC is accepted by the NAC.

A registered principal on behalf of Morgan Stanley shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Michael J. Newman, Senior Regional Counsel FINRA Department of Enforcement, 581 Main Street, 7th Floor, Suite 710, Woodbridge, New Jersey 07095, either by letter that identifies Respondent and case number 2016048805501 or by email from a work-related account of the registered principal of Respondent to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above 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.

[2] The Firm violated NASD Rule 3010 for the conduct prior to December 1, 2014 and FINRA Rule 3110 for the conduct on and after December 1, 2014.

Respondent shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 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.
Respondent agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Morgan Stanley has submitted an Election of Payment form showing the method by which the Firm 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 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;

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 it;

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 its: (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; and

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.

Morgan Stanley Smith Barney LLC

08/17/2017
Date (mm/dd/yyyy)

By: ______________________
Eric Grossman
Authorized Signatory

Reviewed by:

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Susan L. Merrill, Esq.
Counsel for Respondent
Sidley Austin LLP
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New York, NY 10019
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(212) 839-8558

Accepted by FINRA:

09/25/2017
Date

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

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Michael J. Newman
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FINRA Department of Enforcement
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