

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2011025479301**

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

RE: Morgan Stanley Smith Barney LLC (BD No. 149777)  
Respondent

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

**I.**

**ACCEPTANCE AND CONSENT**

- A. MSSB 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 became a member of FINRA on May 19, 2009. MSSB was created through the merger of the Global Wealth Management Group of Morgan Stanley & Co. LLC (BD No. 8209) and the Smith Barney Division of Citigroup Global Markets, Inc. (BD No. 7059) ("CGMI") into a joint venture. In June 2013, Morgan Stanley, a publicly held company, completed the purchase of CGMI's portion of the joint venture and became the sole owner of MSSB (through direct and indirect subsidiaries). The Firm employs over 24,000 registered individuals who work out of approximately 850 branch offices. The Firm engages in a general securities business and its registration with FINRA remains in effect.

**RELEVANT DISCIPLINARY HISTORY**

MSSB has no relevant formal disciplinary history with the Securities and Exchange Commission, any self-regulatory organization or any state securities regulator.

## OVERVIEW

From at least June 2009 through November 2014, MSSB failed to establish, maintain and enforce reasonable supervisory systems and written procedures regarding outgoing wire transfers and branch check disbursements from customer accounts. In addition, from at least June 2009 through September 2011, MSSB failed to establish, maintain and enforce reasonable supervisory systems and written procedures regarding its third-party service provider's coding and acceptance of money orders which were deposited into customer accounts. As a result, three MSSB registered representatives in two different branch offices were able to convert, collectively, \$494,400 from thirteen MSSB customers through fraudulent wire transfers and branch checks sent from the customers' accounts to third-party accounts.

## FACTS AND VIOLATIVE CONDUCT

### Regulatory Background Regarding the Supervision of Customer Funds Transmittals

In October 2004, FINRA (then NASD) issued Notice to Members ("NTM") 04-71, which announced to FINRA's membership that:

*Adequate supervisory systems play an important role in assuring investor protection and the integrity of the markets. Operational and sales practice abuses can stem from ineffective supervisory and supervisory control procedures. The 2002 Gruttadauria case, which involved a branch office manager's misappropriation of approximately \$40 million of customer funds, brought tremendous attention to the ongoing problem of operational and sales practice abuses at firms and the importance of ensuring that firms effectively monitor the activities of their employees.<sup>1</sup>*

NTM 04-71 announced the upcoming implementation of its supervisory control system rule, NASD Conduct Rule 3012. NTM 04-71 stated that member firms must have supervisory controls and procedures reasonably designed to review and monitor wires or checks sent from customer accounts to third-party accounts and outside entities.

In January 2005, NASD Conduct Rule 3012(a)(2)(B)(i) became effective. It specifically requires firms to have procedures that are reasonably designed to review and monitor all transmittals of funds or securities from customer accounts to third-party accounts and outside entities, including banks.

In November 2009, FINRA issued Regulatory Notice 09-64, entitled "Customer Assets," which stated that "[r]ecently, several cases involving the misappropriation of customer assets have highlighted the importance of having adequate procedures for verifying the validity of instructions to transmit or withdraw securities or other assets from customer accounts . . . a number of the cases involved forged letters of authorization." The Regulatory Notice reminded

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<sup>1</sup> In the *Gruttadauria* case, Gruttadauria forged letters of authorization and transferred funds from customer accounts into third-party bank and brokerage accounts. The SEC found, among other things, that Gruttadauria's firm, SG Cowen Securities Corporation, failed to reasonably supervise Gruttadauria. *In the Matter of SG Cowen Securities Corporation*, Exchange Act Release No. 48335 (Aug. 14, 2003).

firms of the strictures of Rule 3012 and urged firms to “review the adequacy of their current policies and procedures to verify the validity of” transmittal requests.

### MSSB’s Registered Representatives Convert Funds from MSSB Customers

Between October 2008 and June 2013, three MSSB registered representatives in two different branch offices converted, collectively, \$494,400 from thirteen MSSB customers by causing fraudulent wire transfers and branch checks to be sent from the customers’ accounts to third-party accounts. During this period, MSSB had no supervisory systems or written procedures to detect and monitor the disbursement of funds from unrelated customers’ accounts to a common third-party account. For example, the Firm’s systems did not include any exception reports that would have identified multiple customer wire transfers going to the same third-party account. Also, from June 2009 through October 2012, MSSB’s supervisory systems and written procedures did not address the comparing of customers’ signatures on outgoing wire transfer request forms with signatures on file. In November 2012, the Firm implemented procedures requiring supervisors to compare and authenticate customer signatures on certain outgoing wire transfer request forms for wire transfer requests greater than \$100,000. After discovering the misconduct, MSSB repaid the affected customers.

#### 1. Conversion Scheme at MSSB’s Paramus, New Jersey Branch

From October 2008 through January 2011, a former MSSB registered representative (“Representative 1”) converted \$94,000 from two MSSB customers.<sup>2</sup> On eleven separate occasions, Representative 1 forged customers’ signatures on outgoing wire transfer request forms. Each of those forms listed, and the funds were wired to, an outside bank account belonging to the spouse of Representative 1. MSSB terminated Representative 1 and he was barred by FINRA in June 2011.

#### 2. First Conversion Scheme at MSSB’s Fort Lauderdale, Florida Branch

From February 2011 through August 2011, a former MSSB registered representative (“Representative 2”) converted \$104,400 from nine MSSB customers. In most instances, Representative 2 forged customers’ signatures on outgoing wire transfer request forms and then wired the customers’ funds to the same outside bank account. Representative 2 then attempted to cover up this conversion by: (1) depositing money orders into a customer’s account in an amount that exceeded MSSB’s allowable threshold for such deposits; and (2) transferring funds within MSSB from one customer to two unrelated customers. MSSB terminated Representative 2 and he was barred by FINRA in December 2011.

#### 3. Second Conversion Scheme at MSSB’s Fort Lauderdale, Florida Branch

From January 2012 through June 2013, a former MSSB registered representative (“Representative 3”) converted \$296,000 from four MSSB customer accounts. On seventeen separate occasions, Representative 3 caused the Firm to issue branch checks out of the customers’ accounts. In each instance, Representative 3 used a MSSB “Verbal Client Instructions Form for Third Party Checks and Journals,” which did not require a customer

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<sup>2</sup> \$40,000 of the conversions took place at MSSB’s predecessor Firm, Morgan Stanley & Co. Incorporated.

signature. The checks in question were made payable to a third-party bank which held the mortgage of Representative 3 and to another third-party bank where Representative 3 maintained an account. Representative 3 also wired \$100,000 between two unrelated customer accounts in order to make one of the customers, whom she had converted funds from, whole. MSSB terminated Representative 3 and she was barred by FINRA in January 2014.

*FINRA Cites MSSB for Failing to Have Adequate Supervisory Systems and Written Procedures to Monitor Wires from Multiple Customer Accounts to a Common Third-Party Account*

In December 2011, following an examination of MSSB's Fort Lauderdale Branch, FINRA cited the Firm for failing to have a supervisory system and written procedures addressing wire requests from multiple customer accounts to the same third-party individual account. In May 2012, MSSB represented that it was creating a report to address those deficiencies. In December 2014, MSSB implemented a report to detect wire transfers from unrelated customer accounts to a common third-party account.

*MSSB's Third-Party Service Provider Miscodes Money Order Deposits*

In or about March 2011, a customer of Representative 2 noticed that \$5,750 had been wired out of her account. The customer contacted MSSB about the matter. To cover up the misappropriation, on March 30, 2011, Representative 2 deposited twelve money orders totaling \$5,750 into the customer's account. The aggregate deposits exceeded MSSB's allowable threshold for money order deposits on any given business day, but were not flagged for review because MSSB's third-party service provider miscoded the money orders as personal checks. Having successfully covered up his misconduct, Representative 2 continued to carry out his misappropriation scheme for another five months without detection by MSSB.

Further investigation by FINRA identified that during 2010 and 2011, at least 66 additional money orders were miscoded by MSSB's third-party service provider for at least six other MSSB branches nationwide.

*MSSB Failed to Establish, Maintain and Enforce a Reasonable Supervisory System and Written Procedures Regarding the Transmittal of Customer Funds*

NASD Conduct Rule 3012 requires FINRA member firms to establish, maintain and enforce written supervisory control policies and procedures that address a variety of activities. Among other things, firms must test and verify that their supervisory procedures are sufficient and amend or create additional supervisory procedures when needed, based on such testing and verification.

NASD Conduct Rule 3012(a)(2)(B)(i) specifically requires firms to have procedures that are reasonably designed to review and monitor all transmittals of funds or securities from customer accounts to third-party accounts and outside entities, including banks.

NASD Conduct Rule 3010(a) requires firms to "establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules."

NASD Conduct Rule 3010(b) provides in part that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable NASD Rules.

MSSB's supervisory systems and written procedures were not reasonably designed to review and monitor the transmittals of funds from customers to third-party accounts and outside entities. These shortcomings are evidenced by the Firm's failure to detect or prevent the conversion of customer funds in MSSB's Paramus and Fort Lauderdale locations as described above. The Firm's supervisory systems and written procedures did not:

- Provide for the review and monitoring of all transmittals of customer funds through wire transfers from multiple customer accounts to the same third-party accounts and outside entities, during the time period from at least June 2009 through November 2014;
- Adequately provide for the review and monitoring of all transmittals of customer funds through branch checks disbursed from multiple customer accounts to the same third-party accounts and outside entities, during the time period from at least June 2009 through November 2014; or
- Adequately address identification requirements for customers who requested wire transfers by fax, email, mail, or during in-person meetings outside of a branch during the time period from at least June 2009 through November 2014, as they did not provide for the comparison of customer signatures on outgoing wire transfer request forms to signatures on file to detect and prevent forged forms from being processed from at least June 2009 through October 2012, or otherwise address these requirements.

Based on the above, from at least June 2009 through November 2014, MSSB failed to establish, maintain and enforce supervisory systems and written procedures that were reasonably designed to review and monitor the transmittals of funds from customer accounts to third-party accounts and outside entities. Through this conduct, MSSB violated NASD Conduct Rules 3010 and 3012 and FINRA Rule 2010.

**MSSB Failed to Establish, Maintain and Enforce a Reasonable Supervisory System and Written Procedures Regarding the Coding and Acceptance of Money Orders**

During the time period of June 2009 through September 2011, MSSB's supervisory system and written procedures were not reasonably designed to review its third-party service provider's coding and acceptance of money orders which were received for deposit into customer accounts. These deficiencies caused the miscoding of money order deposits. Notably, the failures allowed Representative 2 to cover up his prior conversion of \$5,750 from a customer's account and successfully carry out a scheme in which he misappropriated \$104,400 from numerous customer accounts.

Based on the above, from June 2009 through September 2011, MSSB failed to establish, maintain and enforce supervisory systems and written procedures that were reasonably designed to review the coding and acceptance of money orders received for deposit into customer

accounts. Through this conduct, MSSB violated NASD Conduct Rule 3010 and FINRA Rule 2010.

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

- a censure; and
- a fine in the amount of \$650,000.

MSSB agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment(s) are due and payable. MSSB has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

MSSB specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

## II.

### WAIVER OF PROCEDURAL RIGHTS

MSSB 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, MSSB specifically and voluntarily waives any right to claim bias or prejudice 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.

MSSB 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

MSSB understands that:

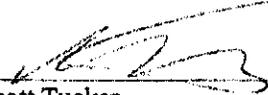
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (“ODA”), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firm;
- C. If accepted:
  - 1. this AWC will become part of the Firm’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. the Firm 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. The Firm 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 the Firm’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; and
- D. The Firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm 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.

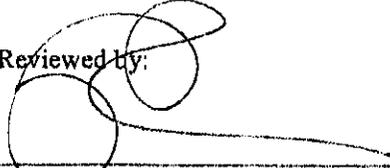
The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that it has agreed to its provisions voluntarily; and that no offer, threat,

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

6-12-15  
Date (mm/dd/yyyy)

By:   
Scott Tucker  
Managing Director

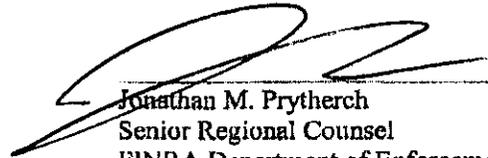
Reviewed by: 

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(561) 650-7900

Accepted by FINRA:

6/19/2015  
Date

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



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