

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2012032646901**

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

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

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 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/RELEVANT DISCIPLINARY HISTORY**

MSSB, headquartered in New York, became a member of FINRA on May 19, 2009. It was created from the merger of Morgan Stanley & Co., LLC’s (“Morgan Stanley”) former retail wealth management business and the Smith Barney division of Citigroup, Inc. (“Citi Smith Barney”). Morgan Stanley became sole owner of MSSB (through direct and indirect subsidiaries) on June 28, 2013. MSSB has approximately 849 branch offices and employs approximately 24,933 registered individuals.

MSSB has no relevant disciplinary history.

**OVERVIEW**

Between February 16, 2012, and May 1, 2013 (the “Relevant Period”), MSSB failed to establish and maintain adequate systems and procedures to supervise the solicitation of retail interest in equity Initial Public Offerings (“IPOs”). During this period, MSSB participated in the distribution of 83 equity IPOs, including such large offerings as Facebook and Yelp. A large

number of MSSB's retail customers participated in the 83 IPOs, with over 68,000 customers investing in the largest offering.

During the Relevant Period, MSSB permitted its retail sales force to solicit from customers either "indications of interest" or "conditional offers," but the Firm failed to adequately supervise this process. Indications of interest and conditional offers have differing requirements. Indications of interest need to be confirmed after effectiveness of the registration statement in order to form a contract of sale. A conditional offer, in contrast, will become binding once it is accepted. Accordingly, customers need to be aware that they are making offers to buy, must understand what their offers are conditioned on, and should be given a reasonable opportunity to revoke their offer following effectiveness of the registration statement.

MSSB's written policies and procedures used the phrases "indication of interest" and "conditional offer" interchangeably, thereby failing to adequately distinguish between the differing requirements associated with each; the Firm failed to provide sufficient guidance and training to its sales staff surrounding the solicitation of conditional offers; and the Firm failed to adequately monitor the process to ensure that it was being done properly. As a result, MSSB violated NASD Rule 3010 and FINRA Rule 2010.

## **FACTS AND VIOLATIVE CONDUCT**

### ***Solicitation of Orders for IPO Shares***

Section 5 of the Securities Act governs the offer or sale of a security in an IPO. Contracts for the purchase or sale of a security are prohibited before the registration statement for the offer and sale of the security has been declared effective by the SEC. Solicitation that does not result in a contract prior to registration, however, is allowed.

One method of soliciting interest in an IPO is for a broker-dealer to solicit indications of interest, which are reconfirmed with the investor after registration becomes effective. Indications of interest do not commit investors to buy securities, which is why they must be reconfirmed before trades are executed. Failure to reconfirm indications of interest constitutes the unauthorized sale of a security in violation of FINRA Rule 2010.

Another method of soliciting interest in an IPO is to seek conditional offers to purchase shares. Conditional offers may be structured in a number of ways, but to prevent them from becoming *de facto* contracts of sale prior to effectiveness of the registration statement, the customer should be given a meaningful opportunity to withdraw the offer following the effectiveness of the registration statement. When the conditional offer works as intended, the offer becomes a contract when the Firm accepts the offer following effectiveness of the registration statement.

### ***MSSB's Policies and Procedures***

MSSB began operations on June 1, 2009, through the merger of Morgan Stanley's retail wealth management business and the Citi Smith Barney division of Citigroup, Inc. Between June 1, 2009, and February 16, 2012, with regard to IPOs, certain MSSB offices operated under legacy Morgan Stanley policies, while others operated under legacy Citi Smith Barney procedures. The two legacy policies offered different guidance regarding the solicitation of offers in IPOs. The

legacy Morgan Stanley policy directed financial advisors to obtain and reconfirm indications of interest from customers, while the legacy Citi Smith Barney policy directed financial advisors to solicit conditional offers to buy securities from investors. Both legacy policies prohibited unauthorized trading.

On February 16, 2012, MSSB issued a compliance notice to reconcile these policies. The new policy, which used the terms “conditional offer” and “indication of interest” interchangeably, directed financial advisors to ascertain the customers’ interest in IPO shares at a specified price range. Customers were to be informed that shares in the IPO would not be guaranteed. No reconfirmation would take place unless the final price fell outside of the indicated range. The policy did not explicitly state that investors would be given an opportunity to withdraw after registration became effective but before acceptance. Offers were not placed in writing, but were recorded as “indications of interest” in MSSB’s order system.

MSSB did not record the terms of the offer other than to track the number of shares requested in the Firm’s order system.

The policy, initiated on February 16, 2012, was suspended on May 1, 2013, and thereafter MSSB has had the practice of reconfirming all customer orders after the final pricing terms were available.

### ***MSSB’s Failure to Supervise***

NASD Rule 3010(a)<sup>1</sup> requires each member to establish and maintain a system to supervise the activities of each registered representative that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA and NASD rules.

The MSSB policies and procedures governing the solicitation of offers in IPOs in effect during the Relevant Period were not reasonably designed to achieve compliance with the Securities laws or FINRA rules: (1) MSSB’s policies and procedures failed to adequately distinguish conditional offers from indications of interest; (2) the Firm failed to provide sufficient guidance and training to its sale staff regarding the solicitation of conditional offers; and (3) the Firm failed to adequately monitor the solicitation of conditional offers to assess compliance with its own policies, or the securities laws and regulations and FINRA rules.

As noted above, the Firm’s policies and procedures conflated indications of interest and conditional offers. The Firm failed to make any distinction between these two terms in its harmonized policies and offered no training or other materials to its financial advisors to clarify the policy. As a result, sales staff and customers may not have properly understood what type of interest was being solicited. The Firm also failed to adequately monitor compliance with its own policies and failed to have procedures designed to ensure that conditional offers were being solicited, which generally arose from oral conversations between registered representatives and potential investors. As a result, the Firm was unable to ensure that its sales staff had properly complied with requirements under the Federal securities laws and FINRA rules.

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<sup>1</sup> NASD Rule 3010 was revised effective February 4, 2013, to update cross-references and make other non-substantive changes within FINRA Rules and By-Laws.

By reason of the foregoing, MSSB violated NASD Rule 3010 and FINRA Rule 2010 for failing to implement adequate systems and procedures to supervise the solicitation of retail interest in equity IPOs between February 16, 2012, and May 1, 2013.

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

1. A censure; and,
2. A fine of \$5,000,000.

MSSB agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payment is due and payable. It 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 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 prejudice of the General Counsel, 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 understand 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 it; and
- 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 response to public inquiries about Respondent's disciplinary records;
  - 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 understand 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 understand all of the provisions of this AWC and has been given a full opportunity to ask questions about 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.

4/21/14  
Date (mm/dd/yyyy)

Morgan Stanley Smith Barney LLC,

By:   
D. Scott Tucker  
Global Head of Litigation, Morgan Stanley

Reviewed by:

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Susan L. Merrill, Esq.  
Sidley Austin LLP  
787 Seventh Avenue,  
New York, New York 10019  
(212) 839-8558 (Phone)

Accepted by FINRA:

\_\_\_\_\_  
Date

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

\_\_\_\_\_  
James E. Day  
Vice President and Chief Counsel  
FINRA Department of Enforcement  
15200 Omega Drive, 3<sup>rd</sup> Floor  
Rockville, MD 20850-3241  
(301) 258-8520 (phone)  
(202) 721-8303 (fax)

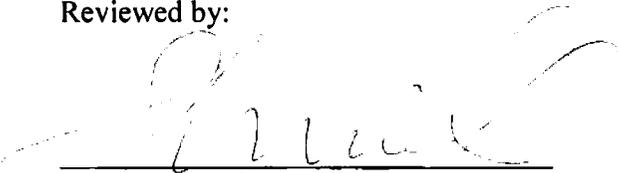
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\_\_\_\_\_  
Date (mm/dd/yyyy)

Morgan Stanley Smith Barney LLC,

By: \_\_\_\_\_  
D. Scott Tucker  
Global Head of Litigation, Morgan Stanley

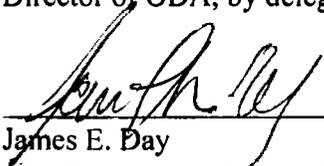
Reviewed by:

  
\_\_\_\_\_  
Susan L. Merrill, Esq.  
Sidley Austin LLP  
787 Seventh Avenue,  
New York, New York 10019  
(212) 839-8558 (Phone)

Accepted by FINRA:

5/6/14  
\_\_\_\_\_  
Date

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

  
\_\_\_\_\_  
James E. Day  
Vice President and Chief Counsel  
FINRA Department of Enforcement  
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