FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
No. 2013037819901

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

FROM: Morgan Stanley & Co. LLC
CRD No. 8209

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Morgan Stanley & Co. LLC ("Morgan Stanley" 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. 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 1970 and is headquartered in New York, New York. The Firm is a full-service brokerage firm with more than 4,000 registered personnel. Among other things, it provides equity research, sales and trading services, and underwriting services.

RELEVANT DISCIPLINARY HISTORY

In 2003, NASD censured Morgan Stanley and other firms as part of the Global Research Settlement and ordered it to pay a total of $125,000,000 for violating NASD Rules 2110, 2210, and 3010, by (1) engaging in acts and practices that created and/or maintained inappropriate influence by investment banking over research analysts, and therefore imposed conflicts of interest on its research analysts, which it failed to manage appropriately; (2) making payments to other broker-dealers identified as part of an underwriting syndicate when the Firm knew that these payments were made, at least in part, for research coverage, and failing to disclose these payments; (3) failing to establish and maintain adequate procedures reasonably designed to protect research analysts from conflicts of interest, and failing to adequately supervise the work of senior analysts, the content of their reports, and the reasonableness of their ratings.[1]

In 2006, FINRA censured Morgan Stanley and ordered it to pay a total of $200,000 for violating NASD Rules 2711, 3010, and 2110, and SEC Rule 482(b)(5). The Firm violated NASD Rules 2711 and 2110 by failing to identify in research reports published between March 2003 and July 2005 the percentage of securities to which the Firm would assign a "buy," "hold/neutral" or "sell" rating, and by not clearly and prominently disclosing "analyst industry view" ratings. The Firm violated NASD Rule 2110 and SEC Rule 482(b)(5) by failing to make certain disclosures in exchange traded fund reports in the required manner. The Firm violated NASD Rules 3010 and 2110 by failing to establish and maintain supervisory procedures reasonably designed to ensure compliance with NASD Rules 2711 and 2110 and related SEC disclosure rules.[2]

In 2010, FINRA censured Morgan Stanley and ordered it to pay a total of $800,000 for violating NASD Rules 2711, 2110, and 3010. The Firm violated NASD Rule 2711(h) and 2110 by publishing certain equity research reports that contained inaccurate disclosures regarding whether the research analyst or a member of the research analyst's household had a financial interest in the securities of the subject company and the nature of such financial interest, and whether the Firm (a) managed or co-managed a public offering for the subject company, (b) received or expected to receive compensation for investment banking services provided to the subject company, (c) received compensation for non-investment banking products or services provided to the subject company, or (d) acted as a market maker in the subject company's securities. Moreover, the Firm failed to include required price charts and disclosures regarding the Firm's valuation method used to generate target prices in certain equity research reports. The Firm violated NASD Rule 2110 by failing to disclose in certain monthly account statements that it had made available independent third-party research as required by the undertakings incorporated in the Research Analyst Settlement. The Firm violated NASD Rules 2711(i), 3010, and 2110 by failing to have adequate policies and procedures to detect and prevent these violations and failing to have a supervisory system reasonably designed to detect that the Firm was not complying with its undertakings in the Research Analyst Settlement.[3]

OVERVIEW

In April 2010, Toys R Us ("TRU") and its private equity owners ("Sponsors") invited Morgan Stanley and other broker-dealers to compete for a role in TRU's planned initial public offering (the "TRU IPO"). To win this investment banking business from TRU, Morgan Stanley's equity research analyst participated in the Firm's solicitation efforts, and the Firm offered favorable research coverage to TRU. Therefore, in the context of the TRU IPO, Morgan Stanley violated two separate provisions of NASD Rule 2711, the research analyst conflict of interest rule: 2711(c)(4), which prohibits research analysts from participating in efforts to solicit investment

[1]In conjunction with Letter of Acceptance, Waiver and Consent No. CAF 030025 (Apr. 24, 2003), Morgan Stanley entered into a Final Judgment with the Securities and Exchange Commission ("SEC") that included, among other things, undertakings with regard to research independence and publication.

[2] Letter of Acceptance, Waiver and Consent No. EAF0401500001 (June 1, 2006).

[3] Letter of Acceptance, Waiver and Consent No. 2008013782301 (Aug. 9, 2010).

banking business; and 2711(c), which prohibits firms from directly or indirectly offering favorable research to obtain investment banking business.

Morgan Stanley allowed its research analyst to participate in the Firm's solicitation efforts by allowing the analyst to present his views to TRU's management and Sponsors during the "solicitation period" – *i.e.*, the period after a company has made known that it intends to proceed with a prospective investment banking services transaction, such as an IPO, and before the company has made a bona fide award of a mandate for the transaction. Before TRU awarded the TRU IPO business, it asked the equity research analysts from the firms competing for the business to make presentations to TRU's management and Sponsors. TRU provided specific topics for the analysts to address and put the firms on notice that, as part of the underwriter-selection process, it would consider each analyst's views of the company and whether the analyst's valuation was consistent with the firm's investment bankers' valuation. As described below, Morgan Stanley's research analyst presented to TRU and its Sponsors on May 5, 2010, during the solicitation period, thereby participating in the Firm's efforts to solicit investment banking business from TRU.

Morgan Stanley also offered favorable research to induce TRU to award the Firm its investment banking business. Following the analyst's presentation, TRU asked Morgan Stanley to complete a template showing an "Equity Commitment Committee approv[ed]" valuation of TRU, which would include the analyst's views on TRU's valuation. TRU and its Sponsors asked the firms to complete the template and provide a Firm-wide valuation that the Firm, including its analyst, would be expected to support after TRU awarded the TRU IPO business, absent unexpected developments. Indeed, TRU told some firms that the purpose of the template was to prevent TRU from being "burned" by an analyst's decision to adopt a negative view of TRU after the company had awarded its investment banking business to the analyst's firm. Morgan Stanley complied with TRU's request.

TRU and the Sponsors selected Morgan Stanley as a co-manager for the TRU IPO. Morgan Stanley declined to participate. TRU eventually decided not to proceed with the offering.

FACTS AND VIOLATIVE CONDUCT

I. Morgan Stanley Violated NASD Rule 2711(c)(4) by Allowing Its Research Analyst to Participate In the Solicitation of Investment Banking Business.

NASD Rule 2711, the research analyst conflict of interest rule, is designed to insulate research analysts from a myriad of conflicts that could impair their impartiality. Taken together, the various provisions of the rule play a critical role in protecting analysts from improper influences and promoting their independent role providing research and analysis to investors. NASD Rule 2711(c)(4) is a key component of the rule that is designed to preclude analysts from participating in efforts to obtain investment banking business from issuers given that analysts typically initiate coverage of issuers when their firms play a role in bringing the issuer public.

NASD Rule 2711(c)(4) states, at the outset, that "[n]o research analyst may participate in efforts to solicit investment banking business." The rule clarifies this broad prohibition by stating further that "no research analyst may, among other things, participate in any 'pitches' for investment banking business to prospective investment banking clients or have other communications with companies for the purpose of soliciting investment banking business." Thus, the rule prohibits a research analyst from being part of the deal team seeking to win investment banking business.

Under NASD Rule 2711(c)(4), an analyst may communicate with an issuer during the solicitation period as part of the analyst's due diligence efforts to gather information about the company, but may not communicate with the issuer in furtherance of soliciting a role for his investment bank in the underwriting. In the context of a meeting requested by an issuer during the solicitation period for the purpose of obtaining an analyst's views as part of the underwriter selection process, as occurred in the TRU IPO, an analyst from a soliciting investment bank may not communicate to the issuer his views about the issuer or the issuer's industry, such as his views about valuation or comparable companies.

In April 2010, TRU and the Sponsors notified several investment banking firms of their interest in bringing the company public through an initial public offering. On April 23, 2010, TRU telephoned several firms and invited them to bid for a role in the TRU IPO and scheduled a "bakeoff" with each firm's investment bankers for April 30, 2010. TRU also notified the firms that, as part of the process of selecting underwriters, it wanted to hear the views of each firm's analyst who would cover the company following the TRU IPO. Each firm understood that TRU would consider the firm's analyst's views in determining whether the firm would receive an underwriting role in the TRU IPO. TRU gave the firms a list of topics it wished the analysts to cover, including the retail industry outlook, valuation, and comparables. TRU scheduled meetings with the analysts for May 4 and May 5, 2010.

On May 4, 2010, TRU and the Sponsors met with the equity research analysts from the firms competing for the TRU IPO business and provided background and financial information on the company for purposes of the analysts' due diligence.

On May 5, 2010, each firm's analyst made a separate presentation to TRU and the Sponsors. Under the circumstances, the analysts' presentations on May 5 constituted part of each firm's pitch for the TRU IPO and therefore violated NASD Rule 2711(c)(4). The presentations occurred during the solicitation period for the TRU IPO. TRU made clear to each firm that its analyst's presentation would be a factor in TRU's determination of whether the firm would be awarded a role in the IPO. Each analyst presentation was structured so that the analyst spoke and TRU management and Sponsors asked questions. These meetings were not designed to provide information to the analyst that the analyst could use to "vet" the proposed transaction.

Morgan Stanley understood that TRU's and the Sponsor's view of the Firm's analyst could influence what underwriting role, if any, it received in the TRU IPO. On April 29, 2010, the day before Morgan Stanley's investment bankers presented to TRU and the Sponsors, a Morgan Stanley investment banker sent an email to several executives at TRU and the Sponsors. The investment banker identified the analyst who would be covering TRU and stated that the Sponsors "may know him from his coverage of [Retailer X]. On [Retailer X], Morgan Stanley is the #1 trader in the stock year to date (15% share)." Certain of the Sponsors recently had taken Retailer X public. Attached to the investment banker's email was a copy of the analyst's research report on Retailer X. The research report gave a positive outlook on Retailer X; it labeled the company as a "Morgan Stanley Best Idea," rated its stock as "Overweight," and stated that "[Retailer X] is now our top pick in the space as we believe 2010 results will demonstrate [the] company's ability to consistently drive sales and margins above market expectations and is the most likely out of the three to get credit for future growth." (emphasis in original)

That same day, in an email, another Morgan Stanley investment banker wrote that he had talked with an executive at one of the Sponsors about the IPO and she told him that "[r]esearch is key: she said they're obviously worried about an analyst not being constructive on the space/story."

That evening, a Morgan Stanley investment banker spoke with several executives from TRU and the Sponsors at a social function. Afterwards, he sent an email to his investment banking colleagues stating that he had "discussed research" with the executives from the Sponsors, that they "kn[ew] [the Morgan Stanley analyst] from [his] [Retailer X] work," and that he "[g]ave them background, et al."

On May 3, 2010, an investment banker sent an email to several investment banking colleagues summarizing a conversation he had with an executive from one of the Sponsors. He wrote, in part, that the executive told him that TRU and the Sponsors had spent the weekend going over the bankers' pitches but "this week is all about meeting the analysts.... He suggested we catch up after they meet our analyst for any other color" on Morgan Stanley's position.

Also on May 3, 2010, the Morgan Stanley analyst emailed his associate, another research analyst, and asked him if he was "up for coming along" to the May 5 presentation to TRU and the Sponsors, "[s]ince we'll feature some [Retailer X] stuff, [it] could be a good opp[ortuni]ty for you and would likely help the effort." He also told him that a colleague had suggested that "we sh[ould] bring [Retailer X's] greatest hits," and asked him to "select the big [Retailer X] reports (incl[uding] [Retailer X's] launch and Best Ideas)" to bring to the presentation.

The analyst submitted the presentation to Morgan Stanley's legal department for approval. The analyst thereafter removed all slides discussing the analyst's coverage of Retailer X. The analyst also was provided guidance on what topics the analyst could discuss during the presentation and advised that he was not permitted to discuss some of the topics requested by TRU, including company-specific commentary and valuation information. Morgan Stanley's analyst abided by these instructions.

On May 5, 2010, senior management at the Firm was informed by one of the Sponsors that "[a] lot depends on the analyst meetings today."

After finishing the presentation, the Morgan Stanley analyst had a chaperoned conference call with the Firm's investment bankers to provide "post mtg feedback."

Additionally, Morgan Stanley complied with TRU's request for a valuation that included the analyst's views.

As a result of the foregoing, Morgan Stanley violated NASD Rule 2711(c)(4) and FINRA Rule 2010.

II. Morgan Stanley Violated NASD Rule 2711(e) by Offering Favorable Research Coverage to Induce Receipt of TRU's Investment Banking Business.

NASD Rule 2711 recognizes that a firm can create a conflict for an analyst and compromise the analyst's independence if it promises favorable research coverage in an effort to win investment banking business. Therefore, NASD Rule 2711 contains a broad prohibition against directly or indirectly offering favorable research: "No member may directly or indirectly offer favorable research, a specific rating, or a specific price target . . . to a company as consideration or inducement for the receipt of business or compensation." Accordingly, in the context of a solicitation period where the issuer has stated that it will consider an analyst's views as part of the underwriter selection process, a firm cannot indicate to a prospective investment banking client its analyst's positive views of the company or the company's prospects, even if honestly held, or the positive prospective valuation the analyst may give the company.

Under the circumstances of the TRU IPO, Morgan Stanley offered favorable research coverage to induce receipt of investment banking business by completing and submitting to TRU, during the solicitation period, a valuation template requested by TRU and the Sponsors.

On May 6, 2010, TRU notified the firms that it would be sending a template to each firm to complete as part of the underwriter-selection process. TRU explained that, in order to be selected as an underwriter, each firm had to provide the requested valuation. TRU and the Sponsors wanted to ensure that, if a firm was selected as an underwriter, its analyst's views would be consistent with the valuation provided by its investment bankers.

Later that day, TRU sent the template to each of the firms along with a cover email. The template asked each firm to provide projected EBITDA and net income for 2010 and 2011, the corresponding valuation multiple for 2010 and 2011, and identify up to five comparable companies used for valuation. In the cover email accompanying the template, TRU wrote that, before selecting underwriters, it wanted each firm to provide (1) "Equity Commitment Committee approval of a definitive equity valuation range," and (2) "what company or companies you would choose for the purpose of determining comparative values, and why." TRU stated that if a firm was selected as an underwriter, the firm, including its analyst, would be expected to stand behind the valuation provided in the template. If the valuation changed, the firm would be expected to show that the change was "directly traceable to unexpected findings during due diligence or unexpected changes in exogenous factors." The templates were due on May 10, 2010.

Morgan Stanley understood that TRU and the Sponsors wanted a final valuation that the entire Firm, including its analyst, would support if selected as an underwriter.

After speaking with TRU about the template, a Morgan Stanley investment banker emailed his colleagues summarizing the conversation. He wrote that, "[h]aving met with the banks and their analysts, they are seeking to get consensus views from each institution at this stage."

Another investment banker responded that he had spoken with an executive from one of the Sponsors, and that the Firm "should go to [Equity Underwriting Committee] as a means of syncing up on valuation with" the Morgan Stanley analyst. In another email, he explained that "this is not a full-blown [Equity Underwriting Committee] (which includes diligence, etc.) but more of an organized valuation sign-off." He added that he had "calls into" the Morgan Stanley analyst and his associate and had sent "an email summarizing the exact client valuation asks so they can prepare."

Another investment banker summarized TRU's request by stating that Morgan Stanley had been "asked to submit a specific firmwide (banking + rsch) valuation point[.]"

In an email discussing the comparables the Firm should include in its template, one investment banker wrote that the Firm has to "have 2 that [the Morgan Stanley analyst] covers, remember this is about keeping us in the hunt for an active" role in the IPO.

Morgan Stanley's investment bankers conferred with their analyst during the process of completing the template.

The Firm's investment bankers emailed the completed template to TRU. The Firm provided all of the information TRU had requested.

By providing TRU the unified valuation it sought, Morgan Stanley indicated to TRU that post-IPO research coverage would be positive and aligned with investment banking.

Shortly thereafter, TRU and the Sponsors selected Morgan Stanley as co-manager for the TRU IPO. Morgan Stanley declined the position.

As a result of the foregoing, Morgan Stanley violated NASD Rule 2711(e) and FINRA Rule 2010.

B. The Firm also consents to the imposition of the following sanctions:

- a censure; and
- a fine in the amount of $4,000,000.

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

Morgan Stanley 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

Morgan Stanley 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, Morgan Stanley 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.

Morgan Stanley 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

Morgan Stanley 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 it; and

C. If accepted:

1. this AWC will become part of Morgan Stanley's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;

2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and

4. Morgan Stanley 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. Morgan Stanley 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.

D. Morgan Stanley 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; 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.

Date: Dec. 5, 2014

Morgan Stanley & Co. LLC

By: ______________________
James Mangan
U.S. Head of Litigation

Reviewed by:

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Accepted by FINRA:

Date: 12/10/14

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

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