

NASDAQ PHLX LLC
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2015048329302

TO: Nasdaq PHLX LLC
c/o Department of Enforcement
Financial Industry Regulatory Authority (“FINRA”)

RE: Morgan Stanley & Co. LLC, Respondent
Broker-Dealer
CRD No. 8209

Pursuant to Rule 9216 of Nasdaq PHLX LLC (“Phlx”) Code of Procedure, Morgan Stanley & Co. LLC (“MSCO” 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, Phlx will not bring any future actions against the 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 Phlx, or to which Phlx 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 Phlx:

BACKGROUND

MSCO became registered with Phlx on June 3, 1970, and with FINRA on June 5, 1970, and its registrations remain in effect. The firm provides services to corporate and broker-dealer clients and institutional investors, and has branches in all 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands. It currently has approximately 3,999 registered representatives. MSCO has no relevant disciplinary history.

SUMMARY

On behalf of the Exchange, the Options Regulation and Trading and Financial Compliance Examinations sections of FINRA’s Department of Market Regulation (the “staff”) reviewed MSCO’s compliance with Phlx rules in connection with MSCO’s use of Professional Customer origin codes on options orders. These reviews led to findings that the firm had failed to correctly mark certain orders with the Professional Customer origin code from January 1, 2011 through April 27, 2017, in violation of Phlx Rules 707,

708, 760, 785(c), 1014(g)(i)(A),¹ 1053 and 1063(e)(i); and Section 17(a) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and Rule 17a-3 thereunder.

In addition, in violation of Phlx Rule 748, and subsequently Phlx General Rule 9, Section 20,² MSCO’s supervisory system and written supervisory procedures (“WSPs”) applicable to the assignment of accurate origin codes to options orders during the period between January 1, 2011 and February 19, 2020, were not reasonably designed to achieve compliance with the recordkeeping provisions of the federal securities laws and the rules of Phlx that govern the accuracy of options order origin codes.

FACTS AND VIOLATIVE CONDUCT

Origin Code Violations

1. Phlx rules, policies, and practices require that when entering an order, a member must record the correct account type or origin code in each order record and as an order detail when entering orders into Phlx’s systems to indicate the kind of account for which the order will be executed and cleared. Each options market has its own origin codes, but at a minimum, all have codes to indicate that an order is being executed for a customer, a firm, or a market maker. Origin codes are important because they are part of the audit trail data for every transaction. They also affect the accuracy of a firm’s books and records and Phlx’s audit trail, which may impact the priority of order execution and Phlx’s surveillance for compliance with Phlx rules and federal securities laws. Finally, they are important for clearing purposes when trades are reported to the Options Clearing Corporation (“OCC”).
2. Pursuant to Phlx Rule 785, a member must submit certain order information in a form prescribed by Phlx on an order record for each customer. Among other things, the origin code determines the order’s priority and is part of the audit trail for every transaction.
3. Phlx operates a customer priority model in which Phlx Rule 1014(g)(i)(A) establishes two account categories: a controlled account, which is any account controlled by or under common control with a broker-dealer, and a customer account, which comprises all other accounts. Rule 1014(g)(i)(A) requires controlled accounts to yield priority to customer orders when competing at the same price.
4. From January 1, 2011 through April 27, 2017, MSCO submitted an inaccurate origin code of Customer rather than Professional Customer on options orders for four of its customers. These orders were routed to and executed on thirteen exchanges, resulting

¹ Phlx Rule 1014(g)(i) was superseded and replaced by Nasdaq Phlx Rule Options 8, Section 25 as of April 16, 2019.

² As per revisions to the Phlx rulebook, Phlx Rule 748(g) became Phlx Rule 748(h) as of November 23, 2012. In addition, Phlx Rule 748(h) was superseded and replaced by Phlx General Rule 9, Section 20(h) as of February 3, 2020. The Firm therefore violated Phlx Rule 748(g) from January 1, 2011 through November 22, 2012, Phlx Rule 748(h) from November 23, 2012 through February 2, 2020, and Phlx General Rule 9, Section 20(h) from February 3, 2020 through February 19, 2020.

in executions of 53,032 orders with a volume of 1,239,368 contracts, of which 90,914 contracts, or approximately 7.34 percent, traded on Phlx. The majority of the orders at issue were mismarked due to configuration issues in various of the firm's order management systems, while other orders were mismarked due to coding errors related to the firm's use of the Financial Information eXchange ("FIX") messaging protocol.

5. Each instance in which the firm executed an order with an incorrect origin code potentially had adverse consequences, such as inadvertently impacting the priority of order execution, creating inaccurate records of purchases and sales, creating an inaccurate audit trail, reporting trades to OCC with inaccurate trade details, and impeding Phlx's ability to surveil for and detect potential violations of its rules and federal securities laws.
6. By marking orders with incorrect origin codes, MSCO violated the following:
 - a. Section 17(a) of the Exchange Act and Rule 17a-3(a)(6) thereunder, requiring a broker-dealer to make and keep a memorandum of each purchase and sale for the account of the broker-dealer (a record that must be accurate), and Phlx Rule 760, which requires every member to make and keep records as prescribed by Phlx and by the Exchange Act and rules thereunder;
 - b. Phlx Rules 785(c) and 1014(g)(i)(A), which require members to submit trade information in such form as may be prescribed by Phlx so that option orders of controlled accounts yield priority to customer orders when competing at the same price;
 - c. Phlx Rule 707, which prohibits a member firm from engaging in conduct inconsistent with just and equitable principles of trade;
 - d. Phlx Rule 708, which prohibits a member firm from engaging in acts detrimental to the interest or welfare of Phlx;
 - e. Phlx Rule 1053, which requires each member organization to supply trade information to Phlx in a form prescribed by Phlx covering each Phlx options transaction for which the member organization is responsible; and
 - f. Phlx Rule 1063(e)(i), which requires each member organization's floor broker to contemporaneously upon receipt of an order and prior to the representation of such an order in the trading crowd record all options orders represented by the floor broker onto the electronic Options Floor Based Management System certain specified information, including the origin code, referred to in Rule 1063(e)(i) as the order type.

Supervisory Violations

7. Phlx Rule 748, and subsequently Phlx General Rule 9, Section 20, require a member organization to establish, maintain and enforce WSPs, and a system of supervision for applying such procedures, that are reasonably designed to supervise the types of businesses and activities in which they and their associated persons engage in order to achieve compliance with, and to prevent and detect violations of, applicable securities laws and regulations, including the By-Laws and Rules of Phlx.³
8. From January 1, 2011 through February 19, 2020, the firm's WSPs mandated that the proper origin code be affixed to all options orders at order entry and indicate the capacity in which such orders are entered. However, the firm's WSPs and supervisory system applicability to the assignment of options origin codes were not reasonably designed. Specifically:
 - a. the firm's order management systems had not been properly coded to ensure that "high-touch"⁴ Professional Customer orders were tagged with the correct Professional Customer origin code;
 - b. its supervisory system did not include any post-order entry follow-up or review of high-touch Professional Customer options orders entered in the Firm's order management systems to determine whether such orders were tagged with the correct Professional Customer origin code; and
 - c. the firm did not provide its Derivatives Sales Desk personnel with sufficient tools or guidance to reasonably ensure that high-touch Professional Customer options orders were marked with the Professional Customer origin code, or supervise those personnel to determine whether high-touch Professional Customer options orders were properly marked.
9. From January 1, 2011 through February 19, 2020, the firm's WSPs and supervisory system required daily and quarterly Professional Customer reviews to be conducted by the firm's Regulatory Control Group (the "Daily RCG Review" and "Quarterly RCG Review", respectively) in order to determine whether options orders were marked with the correct origin code. However, these reviews were not reasonably designed. Because the Daily RCG Review was established to identify discrepancies between the execution and clearing capacities of options orders, it could not detect instances in which Professional Customer orders were mismarked and executed as Customer orders and then reported to the OCC in the "Customer" range. Furthermore, although the Quarterly RCG Review identified whether relevant client accounts were properly classified as Professional Customer accounts, it did not determine whether options orders for Professional Customer accounts were ultimately tagged with the correct

³ As set forth in Footnote 2, Phlx Rule 748 was superseded and replaced by Phlx General Rule 9, Section 20 as of February 3, 2020.

⁴ "High-touch" orders are options orders that are manually entered by sales traders on the firm's Derivatives Sales Desk on behalf of the firm's customers.

origin code.

10. By failing to establish a supervisory system and WSPs reasonably designed to achieve compliance with Exchange Act and Phlx rules applicable to the assignment of accurate options order origin codes, MSCO violated Phlx Rule 748(g) from January 1, 2011 through November 22, 2012, Phlx Rule 748(h) from November 23, 2012 through February 2, 2020, and Phlx General Rule 9, Section 20(h) from February 3, 2020 through February 19, 2020.

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

1. a censure; and
2. a fine of \$650,000, of which \$48,425 shall be payable to Phlx, and the balance of which shall be paid to NYSE American LLC, NYSE Arca, Inc., Nasdaq ISE, LLC, Miami International Securities Exchange, LLC, and Cboe Exchange, Inc.⁵

Acceptance of this AWC is conditioned upon acceptance of similar settlement agreements in related matters between Respondent and each of these self-regulatory organizations.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted a Payment Information form showing the method by which it 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 sanction 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 Phlx's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against the firm;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;

⁵ Although, as set forth in paragraph 4, the violations occurred on thirteen exchanges, the fine is allocated among six exchanges.

- 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 Exchange Review Council 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 Regulatory Officer, the Exchange Review Council, or any member of the Exchange Review Council, 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 Rule 9143 or the separation of functions prohibitions of 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 FINRA's Department of Enforcement and the Exchange Review Council, the Review Subcommittee, or the Office of Disciplinary Affairs ("ODA"), pursuant to Phlx 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 Respondent; and
- C. If accepted:
 - 1. This AWC will become part of the Respondent's permanent disciplinary record and may be considered in any future actions brought by Phlx or any other regulator against the Respondent;
 - 2. Phlx may release this AWC or make a public announcement concerning this agreement and the subject matter thereof in accordance with Phlx Rule 8310 and IM-8310-3; and
 - 3. 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

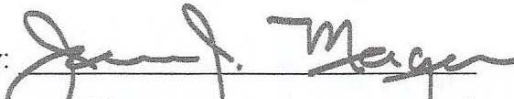
that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of Phlx, or to which Phlx is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Respondent's right to take legal or factual positions in litigation or other legal proceedings in which Phlx 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 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 Phlx, nor does it reflect the views of Phlx 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 the AWC's 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.

4/20/2020
Date

Morgan Stanley & Co. LLC
Respondent

By: 
Name: JAMES J. MANGAN
Title: COUNSEL TO MORGAN
STANLEY & CO LLC

Reviewed by:


Counsel for Respondent
Christian T. Kemnitz
525 W. Monroe, Suite 1900
Chicago, IL 60661
(312) 902-5279

Accepted by Phlx:

June 2, 2020

Date

Andy Hubbartt

Andy Hubbartt
Principal Counsel
Department of Enforcement

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

PAYMENT INFORMATION

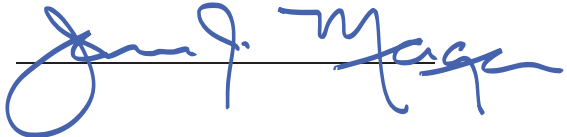
The fine amount will be reflected on an upcoming invoice directed to your firm's chief compliance officer. ***Please DO NOT submit payment at this time.*** If you need to arrange for an alternative method of payment, please contact Nasdaq at (301) 978-8310.

Respectfully submitted,

Respondent

Morgan Stanley & Co. LLC

Date: 4/20/2020

By: 

Name: JAMES J. MANGAN

Title: COUNSEL TO MORGAN
STANLEY & CO LLC