

**THE NASDAQ STOCK MARKET LLC
NOTICE OF ACCEPTANCE OF AWC**

Certified, Return Receipt Requested

**TO: Morgan Stanley & Co. LLC
Mr. James J. Mangan
Managing Director and Head of U.S. Litigation
1585 Broadway
New York, NY 10036**

**FROM: The NASDAQ Stock Market LLC ("Nasdaq")
c/o Financial Industry Regulatory Authority ("FINRA")
Department of Enforcement
9509 Key West Avenue
Rockville, MD 20850**

DATE: August 23, 2018

RE: Notice of Acceptance of Letter of Acceptance, Waiver and Consent No. 20120346239-05

Please be advised that your above-referenced Letter of Acceptance, Waiver and Consent ("AWC") has been accepted on August 22, 2018 by the Nasdaq Review Council's Review Subcommittee, or by the Office of Disciplinary Affairs on behalf of the Nasdaq Review Council, pursuant to Nasdaq Rule 9216. A copy of the AWC is enclosed herewith.

You are again reminded of your obligation, if currently registered, immediately to update your Uniform Application for Broker-Dealer Registration ("Form BD") to reflect the conclusion of this disciplinary action. Additionally, you must also notify FINRA (or NASDAQ if you are not a member of FINRA) in writing of any change of address or other changes required to be made to your Form BD.

You are reminded that Section I of the attached Letter of Acceptance, Waiver, and Consent includes an undertaking. In accordance with the terms of the AWC, a registered principal of the firm is required to notify the Compliance Assistant, Department of Enforcement, 9509 Key West Avenue, Rockville, MD 20850, of completion of the undertaking.

You will be notified by the Registration and Disclosure Department regarding sanctions if a suspension has been imposed and by NASDAQ's Finance Department regarding the payment of any fine if a fine has been imposed.

Morgan Stanley & Co. LLC
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If you have any questions concerning this matter, please contact me at (646) 430-7044.



Jacqueline Gorham
Senior Counsel
Department of Enforcement, FINRA

Signed on behalf of NASDAQ

Enclosure

FINRA District 10 – New York
Michael Solomon
Senior Vice President and Regional Director
(Via email)

Wayne M. Aaron
Milbank, Tweed, Hadley & McCloy LLP
28 Liberty Street
New York, NY 10005
Counsel for Respondent

**THE NASDAQ STOCK MARKET LLC
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20120346239-05**

TO: The NASDAQ Stock Market 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 The NASDAQ Stock Market LLC ("Nasdaq" or the "Exchange") Code of Procedure, Morgan Stanley & Co. LLC, (CRD No. 8209) ("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, Nasdaq will not bring any future actions against the firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The Firm 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 Nasdaq, or to which Nasdaq 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 Nasdaq:

BACKGROUND

1. MSCO, a wholly-owned subsidiary of Morgan Stanley Domestic Holdings, Inc., is a Delaware limited liability company headquartered in New York, New York. The Firm provides services to corporate and broker-dealer clients and institutional investors, and acts as an agency broker-dealer, providing market access and execution services to market participants ("Market Access Clients") for a wide variety of products.
2. The Firm has been registered with Nasdaq since July 12, 2006, and with FINRA since June 5, 1970. Its registrations remain in effect. The Firm does not have a relevant disciplinary history.

Summary

3. In Matter No. 20130384442, the Market Analysis Section of FINRA's Department of Market Regulation ("Market Regulation") reviewed five erroneous order events, for which four Clearly Erroneous Execution ("CEE") petitions were filed, on the Exchange between September 30, 2013 and October 17, 2014, and the Firm's risk management controls and

supervisory procedures for compliance with Rule 15c3-5 of the Securities Exchange Act of 1934 (“SEA”) (the “Market Access Rule”).¹

4. In Matter No. 20140412391, the Quality of Markets Section of Market Regulation reviewed the Firm’s written supervisory procedures (“WSPs”) regarding the process for overriding a Market Access Client’s breach of its assigned messaging controls and related post-trade review process during the period of April 2014 through May 2014, and the Firm’s compliance with the Market Access Rule.
5. The above matters were part of several investigations, which included Matter No. 20120346239, conducted by Market Regulation on behalf of the Exchange and other self-regulatory organizations, including Cboe BZX Exchange, Inc., Cboe BYX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., FINRA, Miami International Securities Exchange, LLC, New York Stock Exchange, Inc., and NYSE Arca, Inc., (collectively, the “SROs”), to review the Firm’s compliance with the Market Access Rule and the supervisory rules of the relevant SROs, including Nasdaq Rules 3010 and 2010A, during the period of July 2011 through July 2017 (the “Review Period”).
6. As a result of Market Regulation’s investigations, it was determined that, during the Review Period, MSCO failed to establish, document, and maintain a system of risk management controls and supervisory procedures, including written supervisory procedures and an adequate system of follow-up and review, reasonably designed to manage the financial, regulatory, and other risks of its market access business.
7. Specifically, during the Review Period, the Firm failed to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders by rejecting orders that exceed appropriate price or size parameters, or that indicate duplicative orders, in violation of SEA Rules 15c3-5(b) and (c)(1)(ii), and Nasdaq Rules 3010, 2110 (prior to 11/21/12), and 2010A (on and after 11/21/12).
8. Further, during the Review Period, the Firm failed to assure the overall effectiveness of its risk management controls and supervisory procedures, in violation of SEA Rule 15c3-5(e)(1), and Nasdaq Rules 3010, 2110 and 2010A.

Violative Conduct

Applicable Rules

9. During the Review Period, SEA Rule 15c3-5(b) required broker-dealers that provide market access to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of their market access business.²

¹ The SEC adopted Rule 15c3-5 effective July 14, 2011. See 17 C.F.R. § 240.15c3-5, *Risk Management Controls for Brokers or Dealers with Market Access*, 75 Fed. Reg. 69792 (Nov. 15, 2010) (Final Rule Release).

² Rule 15c3-5 requires that, broker-dealers providing market access must “appropriately control the risks associated with market access so as not to jeopardize their own financial condition, that of other market participants, the integrity

10. During the Review Period, SEA Rule 15c3-5(c)(1)(ii) specifically required market access broker-dealers to have financial risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders.
11. During the Review Period, SEA Rule 15c3-5(e) required a broker or dealer with market access to establish, document and maintain a system for regularly reviewing the effectiveness of its risk management controls and for promptly addressing any issues. SEA Rule 15c3-5(e)(1) required the broker or dealer to review, no less frequently than annually, the business activity of the broker or dealer in connection with market access to assure the overall effectiveness of its risk management controls and supervisory procedures. Moreover, this rule required, among other things, that the review be conducted in accordance with written procedures and be documented. These provisions were intended to ensure that a broker or dealer “implements supervisory review mechanisms to support the effectiveness of its risk management controls and supervisory procedures on an ongoing basis.”³
12. Rule 15c3-5 requires, among other things, that a broker-dealer with market access document its system of risk management controls and supervisory procedures that are designed to manage the financial, regulatory, and other risks of market access. The broker-dealer must preserve a copy of its supervisory procedures and “a written description of its risk management controls” as part of its books and records for the time period required by SEC Rule 17a-4(e)(7).⁴ The required written description is intended, among other things, to assist SEC and SRO staff to assess the broker-dealer’s compliance with the rule.⁵
13. During the Review Period, Nasdaq Rule 3010(a) required, among other things, that each member firm to “establish and maintain a system to supervise the activities of each . . . associated person[,]” and that such system must be “reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable Nasdaq Rules.”
14. During the Review Period, Nasdaq Rules 2110 and 2010A provided that member firms, in the conduct of their business, shall observe high standards of commercial honor and just and equitable principles of trade.

Overview of MSCO’s Market Access Systems

15. During the Review Period, MSCO provided and maintained market access and executed millions of trades per day for Market Access Clients.

of trading on the securities markets, and the stability of the financial system.” 17 C.F.R. § 240.15c3-5, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010).

³ 75 Fed. Reg. at 69811.

⁴ See 17 C.F.R. § 240.15c3-5(b), which by reference to Rule 17a-4(e)(7), requires a broker-dealer to maintain and preserve such description “until three years after the termination of the use of” the document. See 17 C.F.R. § 240.17a-4(e)(7).

⁵ 75 Fed. Reg. at 69812.

16. During the Review Period, MSCO had a number of different Divisions through which orders were sent to various markets. These Divisions included the Firm's Institutional Equities Division, which conducted traditional agency and principal business, and offered electronic trading services to its Market Access Clients.
17. During the Review Period, MSCO used a variety of systems (*e.g.*, order management systems, algorithms, etc.) through which its Market Access Clients and traders entered orders for routing to and execution on various U.S. securities markets, including the SROs. Those systems contained controls to which the orders submitted were subjected. In addition, MSCO assigned and applied various controls to individual Market Access Clients and traders to which orders submitted by those clients and traders were subjected before submission to the various markets.
18. MSCO generally implemented one or more of the following pre-trade controls: a duplicate order control; a single order notional control (*i.e.*, the value of an order, which is generally calculated by multiplying the share price by the amount of shares); a single order quantity control; a liquidity control (*i.e.*, a percentage of the estimated daily volume in a symbol); and an average daily trading volume ("ADTV") control. The combination of controls and the limits at which these controls were set varied depending upon the Market Access Client or Firm trader. Moreover, the Firm monitored its Market Access Clients and traders' orders on a post-trade basis for compliance with regulatory requirements, including among other things, potentially manipulative activity.

Inadequate Pre-Trade Erroneous Order Controls

19. Despite the various pre-trade controls that the Firm had in place during the Review Period that were designed to prevent the entry of erroneous orders, the Firm failed to implement reasonably designed pre-trade risk management controls applicable to orders submitted by certain Market Access Clients in certain circumstances, and failed to establish and implement supervisory procedures reasonably designed to prevent the entry of potentially erroneous orders during the Review Period, as set forth below.
20. Because MSCO's pre-trade controls were not reasonably designed as applied to certain of the Firm's Market Access Clients, MSCO did not prevent the transmission of certain erroneous equity and options orders to the SROs or to the Exchange, causing 54 erroneous order events (53 for equities and one for options) resulting in one trading halt and one request for a voluntary bust. The erroneous equity order events caused price movement in the related securities, including movement of up to 77% in one instance.
21. There were several primary deficiencies in MSCO's pre-trade price and size controls that resulted in the submission of the orders that caused the above mentioned erroneous order events. In some instances, the Firm did not include controls that took into account the individual characteristics of a security, such as the ADTV of a security. When it did implement an ADTV or a comparable control that took into account the individual characteristics of a security, the limits in certain circumstances were generally set too high to be effective to identify and prevent potentially erroneous orders, absent additional reasonable controls. For example, certain of the Firm's Market Access Client specific controls during the Review Period employed liquidity limits that permitted single orders

of up to a certain percentage of a symbol's predicted daily trading volume. In certain circumstances, the Firm's assigned limits combined with its estimated predicted daily trading volume would have allowed a client to enter single orders of up to several multiples of a symbol's ADTV, which was inadequate without additional reasonable controls.

22. Moreover, between June 26, 2012 and December 12, 2012, there was an error in the Firm's order entry logic that caused the Firm's liquidity check to fail to apply to aggressive (versus passive) orders.⁶ The liquidity check would make a determination as to whether an order was aggressive or passive, and then apply only to aggressive orders by comparing the size of aggressively-priced orders against historic or predicted market trading volume of the subject security. If the ratio between the order quantity and the applicable volume calculation exceeded the pre-set percentage, the order was flagged for review. The Firm intended for the passive versus aggressive determination feature to be turned off for market orders, thereby causing all market orders to be treated as aggressive orders and be subjected to a liquidity check, but it was inadvertently left on for a limited category of market orders. Thus, some market orders were determined to be passive orders and not subjected to a liquidity check.
23. In addition, some Firm Market Access Clients were assigned a "price away" control that applied to limit orders that prevented the entry of an order if it was priced a pre-determined percentage away from the national best bid or offer ("NBBO") for the subject security. In certain circumstances, the threshold applied by the Firm was too high to prevent the entry of potentially erroneous orders without additional reasonable controls.⁷
24. Further, in certain circumstances, the Firm's pricing control assigned limit prices that were the equivalent of the Limit Up/Limit Down ("LULD") bands,⁸ which was not reasonable to prevent the entry of potentially erroneous orders without additional reasonable controls. For example, in certain circumstances the Firm routed short sale orders to an exchange at prices equivalent to the lower end of the LULD band, which resulted in 40 orders to that exchange that were priced between approximately 17% and 41% through the National Best Bid.
25. The acts, practices, and conduct described above in paragraphs 19 through 24 constitute violations of SEA Rules 15c3-5(b) and (c)(1)(ii), and Nasdaq Rules 3010, 2110 (prior to 11/21/12) and 2010A (on and after 11/21/12).

Inadequate Procedures Regarding Messaging Controls

26. During the Review Period, MSCO failed to have written procedures governing the investigation of messaging alerts, and failed to conduct a post-trade review process in the

⁶ An aggressive order is an order that seeks to remove liquidity, whereas a passive order provides liquidity. For example, an aggressive buy order will generally be priced on the offer or higher, and an aggressive sell order will be priced on the bid or lower.

⁷ In situations where the NBBO may not be indicative of the true market, such as for illiquid securities where the NBBO spread can often be particularly wide, rather than use a pre-determined percentage from the NBBO, one effective practice to prevent potentially erroneous orders is to establish an alternative reference point, such as a control that measures the order price as a percentage away from the last sale. See Report on FINRA Examination Findings, December 2017, p. 10. <http://www.finra.org/industry/2017-report-exam-findings>.

⁸ The LULD mechanism is intended to prevent trades in NMS stocks from occurring outside of specified price bands, coupled with trading pauses to accommodate more fundamental price moves.

event a pre-trade messaging control had been breached. Further, the Firm failed to give written guidance to its personnel regarding the proper handling of messaging alerts and failed to employ a process to ensure its personnel were appropriately resolving any messaging alerts. Thus, MSCO failed to establish, document and maintain a reasonable system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures for messaging activity.

27. Further, the Firm failed to maintain on its logs a record reflecting how a messaging control alert was resolved and the rationale for the action taken (including the basis for revising a messaging control threshold). Thus, the Firm could not have been reviewing instances of when alerts were triggered or how they were handled by MSCO personnel. As a result, the Firm cannot adequately demonstrate that it assured the overall effectiveness of its risk management controls and supervisory procedures for messaging activity, as it is required to do no less frequently than annually. Moreover, MSCO's failures in this regard also prevented the Firm from being able to adequately adjust its messaging controls and procedures to help assure their continued effectiveness and to identify any weaknesses in the Firm's controls or procedures.
28. The acts, practices, and conduct described above in paragraphs 26 and 27 constitute violations of SEA Rules 15c3-5(b) and (e)(1), and Nasdaq Rules 3010, 2110 (prior to 11/21/12) and 2010A (on and after 11/21/12).

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

1. A censure;
2. A fine in the amount of \$1,100,000, of which \$150,000 is payable to Nasdaq;⁹ and
3. An undertaking requiring the Firm to address the Market Access Rule deficiencies described in this AWC and to ensure that it has implemented controls and procedures that are reasonably designed to achieve compliance with the rules and regulations cited herein.

Within 120 days of the date of this AWC, MSCO shall submit to the COMPLIANCE ASSISTANT, DEPARTMENT OF ENFORCEMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a written report, certified by a senior management Firm executive, to MarketRegulationComp@finra.org that provides the following information:

- i. A reference to this matter;
- ii. A representation that the Firm has addressed each of the deficiencies described above, including the specific measures or enhancements taken to address those deficiencies; and
- iii. The date(s) this was completed.

⁹ The balance of the sanction will be paid to the self-regulatory organizations listed in Paragraph B.4.

The Department of Enforcement may, upon a showing of good cause and in its sole discretion, extend the time for compliance with these provisions.

4. Acceptance of this AWC is conditioned upon acceptance of similar settlement agreements in related matters between MSCO and each of the following self-regulatory organizations: Cboe BZX Exchange, Inc., Cboe BYX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., FINRA, Miami International Securities Exchange, LLC, New York Stock Exchange, Inc., and NYSE Arca, Inc.

The Firm agrees to pay the monetary sanction(s) in accordance with its executed Election of Payment Form.

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

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

II.

WAIVER OF PROCEDURAL RIGHTS

The Firm specifically and voluntarily waives the following rights granted under Nasdaq's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against it;
- B. To be notified of the Formal 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 Nasdaq Review Council and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Firm specifically and voluntarily waives any right to claim bias or prejudice of the Chief Regulatory Officer, the Nasdaq Review Council, or any member of the Nasdaq 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.

The Firm 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

The Firm 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 Market Regulation and the Nasdaq Review Council, the Review Subcommittee, or the Office of Disciplinary Affairs ("ODA"), pursuant to Nasdaq 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; and**
- 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 Nasdaq or any other regulator against the Firm;**
 - 2. **Nasdaq may release this AWC or make a public announcement concerning this agreement and the subject matter thereof in accordance with Nasdaq Rule 8310 and IM-8310-3; and**
 - 3. **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 Nasdaq, or to which Nasdaq is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's right to take legal or factual positions in litigation or other legal proceedings in which Nasdaq is not a party.**
- 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 Nasdaq, nor does it reflect the views of Nasdaq or its staff.**

[Continued on next page]

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 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.

5/29/2018
Date

Morgan Stanley & Co. LLC, Respondent

By: James J. Max
Name: Thomas J. Morgan
Title: Counsel to Morgan Stanley & Co LLC

Reviewed by: Wayne M. Aaron
Wayne M. Aaron
Milbank, Tweed, Hadley
& McCloy LLP
28 Liberty Street
New York, NY 10005
(212) 530-5000
Counsel for Respondent

Accepted by Nasdaq:

Aug. 22, 2018
Date

Jacqueline Gorham
Jacqueline Gorham, Senior Counsel
FINRA Department of Enforcement

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

ELECTION OF PAYMENT FORM

The Firm intends to pay the fine proposed in the attached Letter of Acceptance, Waiver and Consent by the following method (check one):

- A firm check or bank check for the full amount;
- Wire transfer;

5/21/2008
Date

Respectfully submitted,
Morgan Stanley & Co. LLC, Respondent

By: James J. Morgan
Name: James J. Morgan
Title: Counsel to Morgan Stanley & Co. LLC

Billing and Payment Contact

Please enter the billing contact information below. Nasdaq MarketWatch will contact you with billing options and payment instructions. ***Please DO NOT submit payment until Nasdaq has sent you an invoice.***

Billing Contact Name: _____

Billing Contact Address: _____

Billing Contact Email: _____

Billing Contact Phone Number: _____