

**CBOE BYX EXCHANGE, INC.**  
**LETTER OF ACCEPTANCE, WAIVER AND CONSENT**  
**NO. 20120346239-06**

TO: Cboe BYX Exchange, Inc.  
c/o Department of Enforcement  
Financial Industry Regulatory Authority ("FINRA")

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

Pursuant to Rule 8.3 of the Rules of Cboe BYX Exchange, Inc. ("BYX" or the "Exchange"), 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, BYX 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 BYX, or to which BYX 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 BYX:

**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 as a member of BYX since September 1, 2010 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. 20130392621, the Trading Analysis Section of FINRA's Department of Market Regulation ("Market Regulation") reviewed potentially violative or manipulative trading activity executed through MSCO and occurring on the Exchange between October 2012 and November 2013, and the Firm's compliance with the Rule 15c3-5 of the Securities Exchange Act of 1934 ("SEA") (the "Market Access Rule").<sup>1</sup>
4. The above matter was one 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 EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., FINRA, Miami International Securities Exchange, LLC, The NASDAQ Stock Market 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 BYX Rules 5.1, 5.2, 5.3 and 3.1, during the period of July 14, 2011 through July 2017 (the "Review Period").
5. 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.
6. 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 ensure compliance with all regulatory requirements,<sup>2</sup> including supervising customer trading to detect and prevent potentially violative and manipulative activity, in violation of SEA Rules 15c3-5(b) and (c)(2), and BYX Rules 5.1, 5.2, 5.3 and 3.1.

## Violative Conduct

### Applicable Rules

7. 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.<sup>3</sup>

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<sup>1</sup> 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).

<sup>2</sup> See 75 Fed. Reg. at 69797-98 (noting that "regulatory requirements" include "post-trade obligations to monitor for manipulation and other illegal activity."). See also FINRA's 2009 Priorities Letter (Mar. 9, 2009) (referencing NASD Notice to Members 04-66 (Sep. 2004), which specifically noted the need to ensure that orders entered by a firm or its customers via the firm's trading systems are representative of bona fide trading and quote activity).

<sup>3</sup> 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 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).

8. During the Review Period, SEA Rule 15c3-5(c)(2) required market access broker-dealers to have regulatory risk management controls and supervisory procedures reasonably designed to ensure compliance with all regulatory requirements.
9. During the Review Period, BYX Rules 5.1, 5.2 and 5.3 required, among other things, that each member firm establish, maintain and enforce written procedures to enable it to properly supervise the activities of associated persons to ensure compliance with applicable securities laws and regulations and BYX Rules.
10. During the Review Period, BYX Rule 3.1 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**

11. During the Review Period, MSCO provided and maintained market access and executed millions of trades per day for Market Access Clients.
12. 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.
13. 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.
14. 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 trader. Moreover, the Firm monitored its Market Access Clients and traders' orders on a post-trade basis for ensure compliance with regulatory requirements, including among other things, potentially manipulative activity.

#### **Inadequate Supervision of Customer Trading**

15. Although throughout the Review Period MSCO employed a series of post-trade surveillances and reviews to detect, escalate and ultimately prevent potentially violative or manipulative trading activity, MSCO failed to have any surveillances and reviews to detect,

escalate and ultimately prevent layering<sup>4</sup> and spoofing<sup>5</sup> activity until November 2013. Thus, MSCO failed to adequately supervise its Market Access Clients' trading to detect potentially violative activity during the Review Period.

16. From the beginning of the Review Period until November 2013, MSCO failed to implement post-trade surveillance reports to monitor and review customer trading activity to detect, escalate and ultimately prevent potential layering and spoofing activity. As a result, the Firm failed to detect numerous instances of potential layering and spoofing activity on certain of the SROs and the Exchange between October 2012 and November 2013.
17. For the reasons set forth above, MSCO failed to adequately supervise and surveil its Market Access Clients' trading for potential layering and spoofing activity during the above-referenced period.
18. The acts, practices, and conduct described above in paragraphs 15 through 17, constitute violations of SEA Rule 15c3-5(b) and (c)(2), and BYX Rules 5.1, 5.2, 5.3 and 3.1.

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

1. A censure; and
2. A fine in the amount of \$1,100,000, of which \$55,000 is payable to BYX.<sup>6</sup>
3. 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 EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., FINRA, Miami International Securities Exchange, LLC, The NASDAQ Stock Market LLC, New York Stock Exchange, LLC, and NYSE Arca, Inc.

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<sup>4</sup>Layering is a form of market manipulation that typically includes placement of multiple limit orders on one side of the market at various price levels that are intended to create the appearance of a change in the levels of supply and demand. In some instances, layering involves placing multiple limit orders at the same or varying prices across multiple exchanges or other trading venues. An order is then executed on the opposite side of the market and most, if not all, of the multiple limit orders are immediately cancelled. The purpose of the multiple limit orders that are subsequently cancelled is to induce, or trick, other market participants to enter orders due to the appearance of interest created by the orders such that the trader is able to receive a more favorable execution on the opposite side of the market.

<sup>5</sup>Spoofing is also a manipulative trading tactic designed to induce other market participants into executing trades. Spoofing is a form of market manipulation that generally involves, but is not limited to, the market manipulator placing an order or orders with the intention of cancelling the order or orders once they have triggered some type of market movement and/or response from other market participants, from which the market manipulator might benefit by trading on the opposite side of the market.

<sup>6</sup> The balance of the sanction will be paid to the self-regulatory organizations listed in Paragraph B.3.

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

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 BYX.

## **II.**

### **WAIVER OF PROCEDURAL RIGHTS**

The Firm specifically and voluntarily waives the following rights granted under BYX Rules:

- A. To have a Statement of Charges issued specifying the allegations against it;
- B. To be notified of the Statement of Charges 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 Appeals Committee of the BYX's Board of Directors 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 prejudgment of the Chief Regulatory Officer ("CRO"), in connection with his or her 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 BYX Rule 8.16, 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 the CRO, pursuant to BYX Rule 8.3;
- 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 BYX or any other regulator against the Firm;**
- 2. This AWC will be published on a website maintained by BYX in accordance with BYX Rule 8.18. In addition, this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record; 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 BYX, or to which BYX 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 BYX 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 BYX, nor does it reflect the views of BYX or its staff.**


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

Reviewed by:  
  
Wayne M. Aaron  
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Counsel for Respondent

6/4/2019  
Date

  
Greg Hoogasian  
Senior Vice President & Chief Regulatory Officer  
Cboe BYX Exchange, Inc.

**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; or

Wire transfer.

Respectfully submitted,

Morgan Stanley & Co. LLC, Respondent

5/29/2018

Date

By:

Name:

Title:

James J. McInerney  
James J. McInerney  
Counsel to Morgan Stanley & Co LLC