

NASDAQ ISE, LLC
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2015048329303

TO: Nasdaq ISE, 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 ISE, LLC (“ISE”) Code of Procedure,¹ 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, ISE will not bring any future actions against the firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. MSCO 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 ISE, or to which ISE 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 ISE:

BACKGROUND

MSCO became an ISE member on May 1, 2000, and a member of 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 ISE’s behalf, the Options Regulation and Trading and Financial Compliance Examinations sections of FINRA’s Department of Market Regulation (the “staff”) reviewed MSCO’s compliance with ISE 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

¹ Series 9000 of the Nasdaq BX, Inc. Rules are incorporated by reference into Nasdaq ISE General Rule 5, Section 3, and are thus Nasdaq ISE Rules and thereby applicable to Nasdaq ISE Members, Associated Persons, and other persons subject to Nasdaq ISE’s jurisdiction.

code from January 1, 2011 through April 27, 2017, in violation of ISE Rules 400,² 712(a),³ 713(c),⁴ and 1400(a);⁵ 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 ISE Rule 401, and subsequently ISE Rule Options 9, Section 2,⁶ 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 assure compliance with the recordkeeping provisions of the federal securities laws and the rules of ISE that govern the accuracy of options order origin codes.

Applicable ISE rules require that, when accepting an order, a member must obtain and record an appropriate account type or origin code in each order record and as an order detail when entering orders into ISE’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, among other things, they affect the accuracy of the member organization’s order records and ISE’s audit trail, which may impact the priority of order execution and the ISE’s surveillance for compliance with Exchange rules and federal securities laws. In addition, origin codes must be accurate as part of ensuring that trades are reported to the Options Clearing Corporation (“OCC”) with accurate trade details.

FACTS AND VIOLATIVE CONDUCT

Origin Code Violations

1. ISE requires the use of origin codes. Among other things, the origin code determines the order’s execution priority and is part of the audit trail data of every transaction. Pursuant to ISE Rules 1400(a), 712(a), and 713(c), orders entered into ISE’s systems must include trade information, such as account origin code information, in such form as may be prescribed by ISE. Among other things, the origin code determines the order’s execution priority and is part of the audit trail data for every transaction.
2. 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 in executions of 53,032 orders with a volume of 1,239,368 contracts, of which 227,287 contracts, or approximately 18.34 percent, traded on ISE. The majority of the orders at issue were mismarked due to configuration issues in various of the

² ISE Rule 400 was superseded and replaced by ISE Rule Options 9, Section 1 as of June 6, 2019.

³ ISE Rule 712 was superseded and replaced by ISE Rule Options 6, Section 2 as of June 6, 2019.

⁴ ISE Rule 713 was superseded and replaced by ISE Rule Options 3, Section 10 as of June 6, 2019.

⁵ ISE Rule 1400 was superseded and replaced by ISE Rule Options 6E, Section 1 as of June 6, 2019.

⁶ ISE Rule 401 was superseded and replaced by ISE Rule Options 9, Section 2 as of June 6, 2019. The Firm therefore violated ISE Rule 401 from January 1, 2011 through June 5, 2019, and ISE Rule Options 9, Section 2 from June 6, 2019 through February 19, 2020.

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.

3. 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 ISE's ability to surveil for and detect potential violations of its rules and federal securities laws.
4. By marking orders with incorrect origin codes, the firm violated the following:
 - a. Section 17(a) of the Exchange Act and SEC Rule 17a-3(a)(6)(i) thereunder, requiring a broker-dealer to create and maintain a memorandum of each order, and any other instruction, showing the terms and conditions of the order, and ISE Rule 1400(a), which requires members to make, keep current and preserve such books and records as prescribed by ISE and by the Exchange Act, and the rules thereunder;
 - b. ISE Rule 712(a) and 713(c), which require members to submit trade information in such form as may be prescribed by ISE in order to allow ISE to properly prioritize and match orders and report resulting transactions to OCC for clearance; and
 - c. ISE Rule 400, which requires every member to engage in acts or practices consistent with just and equitable principles of trade.

Supervisory Violations

5. ISE Rule 401, and subsequently ISE Rule Options 9, Section 2, require every member to supervise persons associated with the members to assure compliance with the Exchange Act, ISE rules and OCC rules insofar as they relate to the reporting or clearance of any ISE transaction, or any written interpretation thereof. Every member shall so supervise persons associated with the member as to assure compliance therewith.⁷
6. 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:

⁷ As set forth in Footnote 6, ISE Rule 401 was superseded and replaced by ISE Rule Options 9, Section 2 as of June 6, 2019.

- a. the firm's order management systems had not been properly coded to ensure that "high-touch"⁸ 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.
7. 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 origin code.
8. By failing to establish a supervisory system and WSPs reasonably designed to assure compliance with Exchange Act and ISE rules applicable to the assignment of accurate options order origin codes, MSCO violated ISE Rule 401 from January 1, 2011 through June 5, 2019, and ISE Rule Options 9, Section 2 from June 6, 2019 through February 19, 2020.

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

1. a censure; and
2. a fine of \$650,000, of which \$120,965 shall be payable to ISE, and the balance of which shall be paid to NYSE Arca, Inc., NYSE American LLC, Nasdaq PHLX LLC, Miami International Securities Exchange, LLC, and Cboe Exchange, Inc.⁹

⁸ "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.

⁹ Although, as set forth in paragraph 2, the violations occurred on thirteen exchanges, the fine is allocated among six exchanges.

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

The firm agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. It has submitted a Payment Information 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 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 ISE'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;
- 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, the firm specifically and voluntarily waives any right to claim bias or prejudice 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.

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 Enforcement and the Exchange Review Council, the Review Subcommittee, or the Office of Disciplinary Affairs ("ODA"), pursuant to ISE 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 permanent disciplinary record and may be considered in any future actions brought by ISE or any other regulator against the firm;
 - 2. ISE may release this AWC or make a public announcement concerning this agreement and the subject matter thereof in accordance with ISE Rule 8310 and IM-8310-3;¹⁰ 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 ISE, or to which ISE 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 ISE 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 ISE, nor does it reflect the views of the Exchange 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 it has agreed to the AWC's provisions voluntarily; and that no

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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: Janet Meyer
[Name; and Title, if applicable]
COUNSEL TO
MORGAN STANLEY & CO LLC

Reviewed by:

Christian T. Kemnitz
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(312) 902-5279

Accepted by ISE:

June 2, 2020
Date

Andy Hubbartt
Andy Hubbartt
Principal Counsel
Department of Enforcement

Signed on behalf of ISE, 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

4/20/2020
Date

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