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November 5, 2019

**By Email**

Timothy Henseler, Esq.  
Chief, Office of Enforcement Liaison  
Division of Corporation Finance  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549

Re: *In the Matter of Morgan Stanley Smith Barney LLC*

Dear Mr. Henseler:

We are writing on behalf of Morgan Stanley (“Morgan Stanley”) and Morgan Stanley Finance LLC (“MSFL”) (collectively, “MS”) in connection with Morgan Stanley Smith Barney LLC’s (“MSSB”) anticipated settlement with the United States Securities and Exchange Commission (“SEC” or “Commission”) relating to *In the Matter of Morgan Stanley Smith Barney LLC*. The settlement will result in an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 (the “Securities Act”), Section 15(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Section 203(e) of the Investment Advisers Act of 1940 (the “Advisers Act”), Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the “Order”) against MSSB.

Morgan Stanley is a publicly traded company listed on the New York Stock Exchange and is a reporting company under the Exchange Act. Morgan Stanley qualifies as a “well-known seasoned issuer” (“WKSI”) as defined in Rule 405 under the Securities Act. MSFL is a wholly-owned finance subsidiary of Morgan Stanley, and securities issued by MSFL are fully and unconditionally guaranteed by Morgan Stanley. We respectfully request a waiver from the Division of Corporation Finance (the “Division”), acting pursuant to its delegated authority, or the Commission itself determining that it is not necessary under the circumstances that MS would be considered an “ineligible issuer,” as defined in Rule 405 under the Securities Act, as a result of the Commission entering the Order, which is described below. Consistent with the framework outlined in the Division’s *Revised Statement on Well-Known Seasoned Issuer Waivers* (April 24, 2014) (“Revised Statement”), there is good cause for the Division, on behalf of the Commission, or the Commission itself to grant the requested waiver, as discussed below.

We request that the determination that MS not be considered an ineligible issuer be made effective upon entry of the Order.

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## I. BACKGROUND

MSSB expects to submit an Offer of Settlement that will agree to the Order, which will be presented by the staff to the Commission.

MSSB is dually registered with the Commission as a broker-dealer and investment adviser. MSSB is a wholly owned indirect subsidiary of Morgan Stanley.

The Order will arise in connection with investment recommendations to certain retirement plan and charitable organization brokerage customers (“Eligible Customers”) in which MSSB represented that, in the process of selecting the most economical share class, it used “share class limits and other tools,” including a share class selection calculator, designed to provide customers with the least costly mutual fund share class. The Order will find that MSSB did utilize a share class selection calculator for this purpose, however: (1) the share class calculator contained two operating errors that caused it not to provide the most beneficial share class to Eligible Customers in two specific circumstances, (2) from July 2009 to mid-2012, MSSB did not use the share class calculator for certain legacy retirement plan brokerage customers and other tools employed did not consistently provide the most beneficial share class to Eligible Customers, and (3) MSSB did not code the share class calculator to provide the lowest share class available to charitable organizations eligible for sales charge waivers and did not otherwise have a mechanism for doing so. The Order will find that, as a result of the above referenced issues with the share class selection calculator, MSSB recommended and sold the Eligible Customers more expensive share classes when less expensive share classes were available, contrary to MSSB’s representations to such Eligible Customers.

The Order will find that MSSB willfully violated Sections 17(a)(2) and (3) of the Securities Act. Without admitting or denying the findings in the Order, except as to the Commission’s jurisdiction over MSSB and the subject matter of the proceeding, MSSB will consent to the issuance of the Order and to (i) cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act, (ii) be censured, (iii) pay a civil money penalty in the amount of \$1.5 million, and (iv) pay disgorgement of \$42,389.41 and judgment interest of \$3,369.58.

## II. DISCUSSION

A WKSI is eligible to utilize many important reforms in the securities offering and communication processes that the Commission adopted in 2005. Among other things, a WKSI can register securities for offer and sale under an automatic shelf registration statement, which becomes effective upon filing and is also eligible for the other benefits of the streamlined

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registration process, such as the ability to file automatically effective post-effective amendments to register additional securities and pay registration filing fees on a “pay as you go” basis. Furthermore, a WKSI is also able to communicate more freely than a non-WKSI during the offering process, including through the use of non-term sheet free writing prospectuses.

The Commission also created another category of issuer under Rule 405 – the “ineligible issuer.” A company that is an “ineligible issuer” loses all of the benefits bestowed on a WKSI, including, and most importantly, the ability to utilize an automatic shelf registration statement and to use free writing prospectuses (except in very limited circumstances). An issuer is an ineligible issuer if “[w]ithin the past three years ... the issuer or any entity that at the time was a subsidiary of the issuer was made the subject of any judicial or administrative decree or order arising out of a governmental action that: (A) prohibits certain conduct or activities regarding, including future violations of, the anti-fraud provisions of the federal securities laws; (B) requires that the person cease and desist from violating the anti-fraud provisions of the federal securities laws; or (C) determines that the person violated the anti-fraud provisions of the federal securities laws.”<sup>1</sup>

The entry of the Order against MSSB will render MS an ineligible issuer under Rule 405. As a result, absent a waiver from the disqualification, MS would no longer be able to utilize the benefits of WKSI status.

The Commission retains the authority under Rule 405 to determine “upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer.”<sup>2</sup> The Commission has delegated the authority to the Division to make such a determination.<sup>3</sup> In the Revised Statement, the Division stated that it will consider the following factors in determining whether to grant a waiver:

- the nature of the violation and whether it involved disclosure for which the issuer or any of its subsidiaries was responsible or calls into question the ability of the issuer to produce reliable disclosure currently and in the future;
- whether the misconduct involved a criminal conviction or scienter-based violation;

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<sup>1</sup> 17 C.F.R. 230.405(1)(vi).

<sup>2</sup> 17 C.F.R. 230.405(2).

<sup>3</sup> 17 C.F.R. § 200.30-1(a)(10).

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- who was responsible for the misconduct and what was the duration of the misconduct;
- what remedial steps the issuer took; and
- the impact if the waiver request is denied.

For the reasons set forth below, we respectfully submit that there is good cause for the Division to grant the waiver and determine that it is not necessary for the public interest or the protection of investors that MS be considered an ineligible issuer.

*A. Nature of the Violation and Whether the Violation Casts Doubt on the Ability of the Issuer to Produce Reliable Disclosures to Investors*

The conduct described in the Order does not pertain to any disclosures provided by MS in documents filed with the Commission. Nor does the conduct involve any intentional misconduct by MS or MSSB. Rather, the conduct described in the Order that gave rise to the ineligibility relates only to MSSB – a subsidiary of Morgan Stanley – and arises out of MSSB’s share class selection representations related to the use of MSSB’s automated mutual fund share class selection system (“MFSCI”) and other tools designed to provide customers with the least costly mutual fund share class. The Order will find that while MSSB developed and implemented MFSCI, which, as marketed to customers, was designed to ensure customers received the most cost effective share class by analyzing customer-specific data points and incorporating fund-specific information, there were three issues. The Order will find that: (a) MFSCI had operating and design flaws and that MSSB failed to adequately test and validate the MFSCI to determine whether it worked as designed (*i.e.*, that it was selecting the lowest cost share class option for Eligible Customers), (b) MSSB did not begin to use the MFSCI for its legacy Smith Barney Eligible Customers until mid-2012, and (c) MSSB failed to code the MFSCI to provide sales charge waivers for its charitable organization customers, resulting in certain of those customers not receiving waivers for which they were eligible. As described herein and as noted in the Order, MSSB has developed significant enhancements to its MFSCI, identified the Eligible Customers who purchased more expensive shares than those shares for which they were eligible and completed full remediation of approximately 99% of the overcharges for those customers.<sup>4</sup>

The violation at issue in the Order will pertain to MSSB’s failure to discover and correct MFSCI’s flaws, which the Order will find rendered its representations regarding its share class calculator misleading. There is no connection between the activities of MSSB described in the Order and disclosures prepared by MS as an issuer of securities or in its filings with the Commission.

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<sup>4</sup> Despite reasonable efforts, MSSB is unable to locate and/or contact 226 former MSSB account holders.

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When Morgan Stanley issues securities, including for the purposes of satisfying regulatory capital requirements or addressing funding needs, Morgan Stanley generally utilizes its WKSJ shelf registration statement. Upon receipt of various internal approvals, when Morgan Stanley conducts a shelf takedown in such an instance, it utilizes a lead underwriter for the offering. Morgan Stanley (as issuer) and the lead underwriter are each typically represented by separate outside counsel. Both issuer's and underwriter's counsel assist the issuer and the underwriter(s) with the transaction, including from a disclosure perspective (including prospectus preparation and due diligence and typically including the delivery of disclosure opinions) and a contractual perspective (including underwriting or distribution agreement preparation and delivery of required enforceability and validity opinions). MS's outside auditors also review the applicable documentation and typically deliver a customary comfort letter pursuant to applicable accounting guidelines.

Likewise, when MS issues structured products, it generally utilizes its WKSJ shelf registration statement. When MS issues structured products in such instances, it typically utilizes an underwriter for the offering. MS is represented by outside counsel and such counsel assists both MS and the underwriter with the transaction, including from a disclosure perspective. Outside counsel provide required enforceability, validity and tax opinions for each transaction. In order to conduct such an offering, MS must obtain various internal approvals.

MS uses free writing prospectuses in connection with all of the types of offerings described above. As is the case with the other offering documents, all such free writing prospectuses are reviewed by outside counsel, in addition to being reviewed by or on behalf of various groups within MS. To the extent that any free writing prospectus is a "retail communication" subject to the Financial Industry Regulatory Authority's communications rules, such free writing prospectus will also be prepared and used in accordance with such rules (including the requirements related to principal review and approval).

Furthermore, MS's Form S-3 incorporates by reference Morgan Stanley's most recent annual report on Form 10-K and its current and periodic reports filed pursuant to the Exchange Act. As required by SEC rules, MS has established and maintains a system of disclosure controls and procedures designed to ensure that it is able to timely record, process, summarize and report information (financial and otherwise) required in its public reports and communicates this information to management. Further to these controls and procedures, MS has established a committee comprised of MS personnel responsible for significant disclosure and control areas and for oversight of the accuracy and timeliness of the disclosures made by MS in its public reports filed with the SEC. External attendees also include MS's independent auditors and outside disclosure counsel. Among other responsibilities, this committee and other senior officers responsible for disclosure and control areas help determine disclosure obligations on a

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timely basis. The committee also reviews MS's disclosure controls and procedures on a quarterly basis to determine the effectiveness thereof. MS also has implemented other processes to assist it and its officers with its certification and disclosure requirements, including receipt of "back-up" certifications.

None of the conduct described in the Order implicates in any way the ability of MS to issue reliable disclosures.

*B. The Order Is Not Criminal in Nature or Involve Scier-er-Based Fraud*

The Revised Statement indicates that the Division "will review whether the conduct involved a criminal conviction or scier-er-based violation as opposed to a civil or administrative non-scier-er based violation." The Order does not involve a criminal conviction and does not state that MSSB acted with scier-er or intent to defraud. In particular, the violations found in the Order, which trigger disqualification, are Sections 17(a)(2) and (3) of the Securities Act, which are non-scier-er based anti-fraud provisions.

*C. The Persons Responsible for the Misconduct and the Duration of the Misconduct*

The Commission has not charged any individuals associated with MSSB with violations in connection with the conduct underlying the Order, and we understand that no such charges are forthcoming. Rather, the Order will find that MSSB relied on an automated system – MFSCI – to select the lowest cost share class available to Eligible Customers, but MSSB's failure to discover and correct the MFSCI's flaws caused MSSB to recommend and sell to Eligible Customers more expensive share classes when less expensive share classes were available, contrary to certain of MSSB's representations to those Eligible Customers.

The conduct at issue in the Order occurred from at least July 2009 through December 2016. Upon learning of the issues with MFSCI, as detailed below in section II.D, MSSB promptly identified the Eligible Customers who purchased more expensive shares than those shares for which they were eligible, completed a full remediation of approximately 99% of the overcharges for those customers and corrected the flaws in the MFSCI system.

## *D. Remedial Steps*

As noted by the Commission in the Order, MSSB has taken substantial and prompt remedial steps, to address the conduct at issue in the Order. Specifically, MSSB has:

- Identified the Eligible Customers who purchased more expensive shares than those shares for which they were eligible, and completed full remediation of approximately 99% of the overcharges for those customers.<sup>5</sup> From July 2009 onward, Eligible Customers paid a total of \$12,252,833 in up-front sales charges, contingent deferred sales charges, and higher ongoing fees and expenses from purchases of mutual fund share classes for which they did not receive an applicable sales charge waiver or did not otherwise receive the most cost-effective share class for which they were eligible that was available on MSSB's platform during the Relevant Period. MSSB issued payments of these amounts, including \$1,576,749 in interest, to Eligible Customers.
- Even though certain transactions occurred outside of the statute of limitations period under 28 U.S.C. § 2462 for disgorgement, MSSB voluntarily paid substantial remediation to customers outside of that period. Specifically, MSSB's reimbursement payments include a total of \$7,558,409 relating to transactions during the applicable statutory limitations period and a total of \$6,271,173 before that period.
- Offered Eligible Customers holding share classes with higher ongoing fees and expenses the ability to sell those share classes and buy the share classes with the lowest expenses for which they are eligible, at no cost to customers.
- Corrected the flaws in the MFSCI system through system enhancements and improvements, including: (1) blocking retirement account trades in Class C shares, (2) enhancing its Order Entry System to route all automatic periodic purchase trades through the share-class selection filters; and (3) during the time that MSSB was implementing the enhancements, manually reviewing and changing any incorrect automatic period purchase instructions.
- As of July 1, 2018, implemented changes to the mutual fund share class offerings for brokerage accounts, which ensures that eligible retirement plan customers

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<sup>5</sup> See *id.*

receive the most beneficial available share class. The current share class offering structure differs in the following ways:

- *Standardized Sales Charge Waivers for Class A Shares:* Class A mutual fund purchases by eligible retirement plan accounts are no longer subject to a front-end sales charge; and
- *Class R Share Closure:* MSSB closed all retirement-specific share classes (typically R share classes) as a result of the adoption of the standardized Class A share load waiver program for all fund families.

Furthermore, mutual funds generally no longer offer waivers to charitable organizations. Finally, the legacy accounts were converted to Morgan Stanley's systems in 2012 and therefore were a purely historical issue.

MSSB thus has taken concrete steps to remediate the conduct at issue in the Order. The steps were designed to remediate Eligible Customers and enhance MSSB's overall systems going forward.

### *E. Previous Actions*

MSFL and/or Morgan Stanley have previously been granted waivers regarding their WKSI status in the following instances:

- *In the Matter of Morgan Stanley Smith Barney, LLC* (June 29, 2018) related to MSSB's failure to adopt policies and procedures reasonably designed to prevent MSSB personnel, and in particular one financial advisor, from misusing and misappropriating funds in client accounts.
- *In the Matter of Morgan Stanley Smith Barney, LLC* (February 14, 2017) related to MSSB's solicitation of advisory clients to purchase certain single-inverse exchange traded funds without adequately implementing MSSB's written compliance policies and procedures designed to prevent violations of the Advisers Act.
- *In the Matter of Morgan Stanley Smith Barney, LLC* (January 24, 2017) related to MSSB's failure to adequately disclose to investors material information about a foreign exchange trading program.

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- *In the Matter of Morgan Stanley Smith Barney, LLC* (January 13, 2017) related to MSSB's inadvertent errors in advisory client fee billing, failure to obtain annual surprise custody examinations, and failure to maintain signed client contracts.
- *In the Matter of Morgan Stanley Investment Management, Inc. and Sheila Huang* (Dec. 22, 2015) related to a series of unlawful prearranged trades conducted by a portfolio manager/trader formerly employed by Morgan Stanley Investment Management, Inc. ("MSIM").
- *In the Matter of Morgan Stanley & Co. LLC* (June 18, 2015) related to the failure by Morgan Stanley & Co. LLC ("MS&Co.") to conduct adequate due diligence on certain municipal securities offerings in connection with the Municipalities Continuing Disclosure Cooperation Initiative. This matter was self-reported to the Commission and the settlement involved 36 underwriters.
- *In the Matter of Morgan Stanley & Co. LLC; Morgan Stanley ABS Capital I Inc.; and Morgan Stanley Mortgage Capital Holdings LLC* (July 24, 2014) related to understatements of current and/or historically delinquent loans collateralizing two subprime residential mortgage-backed securities offerings in which MS&Co. acted as underwriter, Morgan Stanley ABS Capital I Inc. acted as depositor and Morgan Stanley Mortgage Capital Holdings LLC acted as sponsor.
- *In the Matter of Morgan Stanley Investment Management, Inc.* (Nov. 16, 2011) related to conduct by MSIM in connection with the investment advisory fees charged to a particular fund by the fund's Malaysian sub-adviser and representations made to investors and the fund's board of directors regarding the nature of the services provided by the sub-adviser. MSIM served as the primary investment adviser to the fund.
- *In the Matter of Morgan Stanley & Co. Incorporated* (July 20, 2009) related to conduct by Morgan Stanley & Co. Incorporated in connection with recommendations to certain advisory clients of certain money managers who were not on a pre-approved list of money managers, contrary to the procedures described in disclosure materials provided to clients, failing to disclose the conflicts of interest associated with such recommendations, failing to supervise a financial adviser involved in such violations and failing to maintain certain books and records.

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- *In the Matter of Morgan Stanley & Co. Incorporated* (May 11, 2007) related to conduct by Morgan Stanley & Co. Incorporated in connection with best execution owed to retail customers on over-the-counter orders.
- *In the Matter of Certain Auction Practices* (May 31, 2006) related to conduct by Morgan Stanley & Co. Incorporated and Morgan Stanley DW Inc. in connection with auction rate securities.

The conduct that was the subject of the above-referenced waiver requests and the conduct in this matter do not relate to MS's conduct as an issuer of securities and does not call into question MS's ability to make accurate and reliable disclosures. Further, there is no relationship between the conduct in this matter and any of the actions underlying the above-referenced waiver requests. Lastly, MSSB has taken remedial steps related to the conduct described in the Order to help prevent such conduct from recurring.

## *F. Impact on Issuer if Request is Denied*

The Division's Revised Statement indicates that it will "assess whether the loss of WKSI status would be a disproportionate hardship in light of the nature of the issuer's conduct." Given the conduct attributed to MSSB in the Order, we respectfully submit that the impact of MS being designated an ineligible issuer, resulting in the loss of WKSI status for MS, would be unduly severe.

Morgan Stanley is a global financial institution that relies on automatic shelf registration statements to conduct its day-to-day business transactions, including frequent offers and sales under automatic shelf registration statements. For Morgan Stanley, the automatic shelf registration process provides a critical means of access to the capital markets, which is an essential source of funding for its global operations, in a timely and efficient manner. In addition, many Morgan Stanley institutional and retail clients seek to purchase investment products that are structured to meet the specific investment goals of those clients. These structured products are securities issued by MS and are often sold in offerings registered with the SEC using Morgan Stanley's automatic shelf registration statement, as described further below. Consequently, the ability to avail itself of automatic shelf registration and the other benefits available to a WKSI is extremely important to MS's ability to raise capital, conduct its operations and operate client-facing businesses.

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As an ineligible issuer, MS would, among other things, lose the ability to:

- file automatic shelf registration statements to register an indeterminate amount of securities;
- offer additional securities of the classes covered by a registration statement without filing a new registration statement;
- allow Morgan Stanley to include certain information omitted from the registration statement at the time of effectiveness through the filing of prospectus supplements or incorporated Exchange Act reports;
- take advantage of the “pay as you go” filing fee payment process;
- qualify a new indenture under the Trust Indenture Act of 1939, if needed, without filing or having the Commission declare effective a new registration statement; and
- use free writing prospectuses other than one that contains only a description of the terms of the offered securities or the offering itself.

Morgan Stanley currently has on file an automatic shelf registration statement on Form S-3 that registers indeterminate amounts of multiple classes of securities. As described above, Morgan Stanley amended its registration statement in February 2016, to add Morgan Stanley Finance LLC (“MSFL”) as an issuer. Securities issued by MSFL are fully and unconditionally guaranteed by Morgan Stanley. For the period from January 1, 2016 to June 30, 2019, MS, including securities offered by Morgan Stanley and MSFL, priced approximately 3,319 securities offerings under its automatic shelf registration statement, with a total principal amount of approximately \$94,572,715,660.34. MS uses its automatic shelf registration statement to offer and sell three principal categories of securities.<sup>6</sup>

- First, Morgan Stanley issues securities to meet its regulatory capital requirements, such as preferred stock and subordinated debt. For the period from January 1, 2016 to June

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<sup>6</sup> Morgan Stanley priced approximately 314 securities offerings with a total principal amount of approximately \$81,390,553,950.00 and MSFL priced approximately 3,005 securities offerings with a total principal amount of approximately \$13,182,161,710.34.

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30, 2019, one offering, with a total principal amount of \$1,000,000,000.00, was conducted pursuant to the automatic shelf registration statement.<sup>7</sup>

- Second, MS issues senior debt securities with a fixed and/or floating rate of interest. For the period from January 1, 2016 to June 30, 2019, approximately 49 offerings, with a total principal amount of approximately \$78,762,400,600.00, were conducted pursuant to the automatic shelf registration statement, including offerings by both Morgan Stanley and MSFL.
- Finally, MS issues a variety of structured products linked to the performance of different underlying assets and sells them to its clients and through third-party dealer relationships. These structured products include: market-linked notes (which provide investors with a market-based return in addition to the return of par or some other guaranteed amount); leveraged performance investments (which provide enhanced returns relative to an underlying asset's actual return); enhanced yield investments (which may provide current income derived from taking a view on an underlying asset); and access investments (which provide exposure to the returns of less-accessible sectors, asset classes or investment strategies). For the period from January 1, 2016 to June 30, 2019, approximately 3,269 offerings, with a total principal amount of approximately \$14,810,315,060.34, were conducted pursuant to the automatic shelf registration statement, including securities offered by Morgan Stanley and MSFL.

The vast majority of these securities offerings used a free writing prospectus as one of the offering documents. The ability to use free writing prospectuses enables MS to communicate more freely with its prospective clients and provide them with important information needed for an informed investment decision. For example, many of the free writing prospectuses used by MS in its offerings are investor education materials. MS would be at a disadvantage compared to other issuers if it were unable to use these types of communications, which have become commonplace following the securities offering reforms adopted by the Commission in 2005. For example, if MS was unable to use certain free writing prospectuses, certain third-party dealers may refuse to sell its structured notes due to their marketing documentation requirements.

Accordingly, certain MS lines of business would encounter significant difficulty if the benefits of WKSI status described above became unavailable. The ability to avail itself of these benefits is extremely important to MS's ability to raise capital efficiently and conduct its operations. As noted, these WKSI benefits are also important to a number of MS's investment client-facing businesses as they allow them to efficiently offer structured products and provide

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<sup>7</sup> MSFL did not offer any securities to meet regulatory capital requirements.

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educational materials to clients about their terms, in the same manner as other peers in these markets. Denial of this request would hinder necessary access to the capital markets and these client-facing investment markets by significantly increasing the time, labor, and cost of such access, a result that would be inequitable to its shareholders and its clients.

### III. CONCLUSION

We respectfully submit that the Division, on behalf of the Commission, or the Commission itself should grant the request for this waiver because the Order does not find violations of scienter-based fraud or involve criminal conduct; the Order does not find disclosure violations by Morgan Stanley or MSFL; and MSSB has undertaken extensive remedial actions to enhance its overall systems. Additionally, MSSB has fully cooperated with the Division of Enforcement in connection with its investigation. In light of these considerations, MS respectfully submits that it has shown good cause that it is not necessary under the circumstances that MS be considered an ineligible issuer. Accordingly, we request that the Division, on behalf of the Commission, or the Commission itself make the determination that there is good cause for MS not to be considered an ineligible issuer as a result of the Order.

If you have any questions regarding any of the foregoing, please do not hesitate to contact me at 617-223-0362.

Very truly yours,



Elizabeth A. Marino