

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73801 / December 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16310

<p>In the Matter of</p> <p>MORGAN STANLEY & CO. LLC</p> <p>Respondent.</p>

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND IMPOSING
A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Morgan Stanley & Co. LLC (“MS & Co.” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that:

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

1. The subject of these proceedings is MS & Co.'s violation of Exchange Act Rule 15c3-5 ("Rule 15c3-5" or the "Market Access Rule"), which requires brokers or dealers to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks associated with providing customers access to the markets. MS & Co. is a registered broker-dealer that offers its institutional customers direct market access through an electronic trading desk that is part of the firm's Institutional Equity Division (Morgan Stanley Electronic Trading, or "MSET").

2. One requirement of the Market Access Rule is that broker-dealers reasonably design controls and supervisory procedures to prevent the entry of orders that exceed pre-set aggregate credit thresholds for customers. The Commission adopted the Market Access Rule, in part, to require that brokers or dealers, as gatekeepers to the financial markets, "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."² The requirement that a broker-dealer establish automated pre-trade aggregate credit thresholds is important because such limits "should protect broker-dealers providing market access, as well as their customers and other market participants, by blocking orders that do not comply with applicable risk management controls from being routed to a securities market."³

3. The events of October 25, 2012 revealed that MS & Co.'s controls and supervisory procedures were not reasonably designed to prevent the entry of orders that exceed pre-set aggregate credit thresholds for customers. On that day, MSET twice increased pre-set aggregate credit thresholds for its customer Rochdale Securities LLC ("Rochdale") (a registered broker-dealer that accessed MSET's platform on behalf of its own institutional customers), initially from \$200 million to \$500 million and subsequently from \$500 million to \$750 million, when it received a series of orders for approximately \$525 million of Apple, Inc. ("Apple") stock—an amount that would have exceeded Rochdale's threshold had it not been increased by MSET. Unbeknownst to MSET, David Miller ("Miller"), the registered representative at Rochdale with whom MSET personnel were interacting on October 25, 2012, was using these orders to commit fraud. A Rochdale customer purportedly instructed Miller to purchase 1,625 shares of Apple. Miller instead purchased 1,625,000 shares of Apple at a cost of almost \$1 billion, scheming to personally profit by sharing the anticipated proceeds with the customer if Apple's stock price increased. Miller falsely informed Rochdale that he was trading on behalf of a customer. Approximately 860,200 of the Apple shares Miller purchased were executed through MSET, and Miller falsely informed MSET that these trades were on behalf of a Rochdale customer. When Apple's stock price began dropping, and it became clear that the trades would not be profitable,

² Risk Management Controls for Brokers or Dealers with Market Access, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010) (final rule release).

³ *Id.* at 69801.

Miller falsely claimed that he had made a mistake, leaving Rochdale holding the unauthorized purchase and suffering a loss of approximately \$5.3 million.⁴

4. As explained when the Commission adopted the Market Access Rule, a broker-dealer should make determinations of appropriate credit thresholds for each customer for which it provides market access “based on appropriate due diligence as to the customer’s business, financial condition, trading patterns, and other matters, and document that decision. In addition, the Commission expects the broker-dealer will monitor on an ongoing basis whether the credit thresholds remain appropriate, and promptly make adjustments to them, and its controls and procedures, as warranted.”⁵

5. Beginning in November 2011 and continuing through at least October 25, 2012 (the date on which MS & Co. twice increased aggregate credit thresholds for Rochdale), MS & Co.’s system of risk management controls and supervisory procedures was not reasonably designed to manage the risks associated with the market access it provided and, as a result, MS & Co. violated the Market Access Rule. In particular, MS & Co. did not have reasonably designed controls and supervisory procedures because those controls and procedures, as reflected in MS & Co.’s Rule 15c3-5 written supervisory procedures (“WSPs”), did not reasonably guide MSET personnel in determining whether to modify the customer credit thresholds that are required under Rule 15c3-5(c)(1)(i), including in situations in which personnel were confronted with a customer order to purchase equity securities in an amount that exceeded the threshold. As a result of these inadequate controls and procedures, MS & Co. twice increased Rochdale’s aggregate credit threshold on October 25, 2012 without appropriate due diligence to ensure that the credit increases were warranted.

Respondent

6. Morgan Stanley & Co. LLC (“MS & Co.”) is a U.S.-based broker-dealer and a wholly-owned subsidiary of Morgan Stanley. MS & Co. is registered with the Commission pursuant to Section 15 of the Exchange Act and is a Financial Industry Regulatory Authority member. MS & Co. has its principal business operations in New York, New York. Morgan Stanley Electronic Trading (“MSET”) is a trading desk within MS & Co.’s Institutional Equity Division that offers its customers direct market access.

MS & Co.’s Rule 15c3-5 Written Supervisory Procedures and Controls

7. MS & Co.’s Rule 15c3-5 WSPs from approximately November 2011 until at least October 25, 2012 required the firm to establish pre-trade single order thresholds and aggregate credit thresholds for new MSET customer accounts. Single order thresholds included trading limits established for new customers based on the maximum order size that a customer may submit in a

⁴ Miller was charged both civilly and criminally for his actions. See *SEC v. David Miller*, Case No. 3:13-cv-00522-JBA (D. Conn.), Litigation Rel. No. 22671 (April 15, 2013) and *United States v. David Miller*, No. 3:13-cr-00075 (D. Conn.), Litigation Rel. No. 22872 (Nov. 21, 2013). On November 19, 2013, Miller was sentenced to 30 months’ imprisonment, followed by three years of supervised release.

⁵ 75 Fed. Reg. at 69802.

single order, set at both a share level (total number of shares that a customer may submit in a single order) and “notional dollar” level (the maximum dollar size of a single order defined as share price multiplied by share quantity). Aggregate credit thresholds were daily trading limits for a customer based on parameters including: (a) total number of shares traded during a day; (b) notional net value of trades during a day (purchases less sales); and (c) notional gross value of trades during a day (purchases plus sales).

8. Single order thresholds were configured as either “hard” or “soft” in Client Flow Manager (“CFM”), MSET’s risk management proprietary software which launched automatically on the computers of all MSET client coverage personnel each morning. Hard thresholds in CFM rejected a customer order outright if the order exceeded the single order pre-set threshold. Soft thresholds in CFM held a customer order from being routed to the market by generating an alert to the account representative who could either release the order to the market or reject the order back to the customer. MSET determined whether to set single order thresholds as soft or hard (or a combination of both). Aggregate credit thresholds were always configured as hard in CFM. As such, orders whose parameters exceeded the aggregate credit thresholds could not be released to the market without modification of the threshold.

9. MS & Co.’s WSPs required it to document the hard thresholds, including both hard single order thresholds and the hard aggregate credit thresholds established pursuant to Rule 15c3-5. These hard thresholds could be modified (e.g., increased) subject to supervisory approval. MS & Co.’s WSPs also required the approval and the reason for the modification to be documented. The process in practice occurred as follows: (i) an MSET account representative (typically in direct contact with a customer) would request that a desk supervisor sitting nearby enter an increase to the customer’s hard threshold; (ii) that desk supervisor would then enter the threshold change in MSET’s system along with a reason for the change (choosing from a drop-down menu in MSET’s computer system without further annotation or explanation); and (iii) a separate desk supervisor would then confirm the threshold change in the system in order for it to take effect. A number of MSET supervisors were authorized to enter and/or confirm requests to increase hard thresholds.

10. During the relevant period, MS & Co.’s WSPs did not contain guidance or criteria on what factors to consider, if any, when evaluating whether to modify a customer’s single order threshold or aggregate credit threshold.

11. During the relevant period, the most common documented reason for increasing a customer’s aggregate credit threshold was “trading style,” which was one of several choices in the drop-down menu. According to relevant MSET personnel, “trading style” was a general term encompassing the manner in which a customer was trading on a particular day.

The October 25, 2012 Event and Aftermath

12. When Rochdale, a registered broker-dealer, first became an MSET customer in mid-2009, MSET placed Rochdale into a non-customized “starter bucket” with a \$200 million

aggregate credit threshold. At that time, MS & Co.'s WSPs did not contain guidelines, criteria, or other qualifications to use when determining initial aggregate credit thresholds for a customer.

13. On October 25, 2012, the day of an Apple earnings announcement, Miller, a registered representative at Rochdale, entered a series of purchase orders in Rochdale's internal entry system totaling 1,625,000 shares of Apple at a cost of almost \$1 billion. Ultimately, approximately 860,200 of the Apple shares purchased by Miller were executed by MSET for an aggregate value of approximately \$525 million.

14. At the time, Rochdale was subject to the \$200 million aggregate credit threshold. To accommodate Miller's orders, MSET twice raised Rochdale's aggregate credit threshold concerning the maximum notional net value Rochdale could trade—first from \$200 million to \$500 million at approximately 12:39 p.m. and then from \$500 million to \$750 million at approximately 3:23 p.m.⁶ Both increases occurred after brief conversations between the MSET account representative, who was in direct communication with Miller by instant message, and an MSET desk supervisor sitting near the account representative who entered (or directed a colleague to enter) the increase. Miller did not know that Rochdale's aggregate credit thresholds were being approached (and he did not seek the increases); rather, the MSET account representative requested the increases of her supervisor upon determining that Miller's order flow would exceed the existing threshold and upon confirming with Miller that the orders were not erroneously entered. MSET did not inform Miller (or anyone else at Rochdale) that MSET was increasing Rochdale's aggregate credit threshold. MS & Co.'s WSPs contained no criteria or guidance for MSET personnel to consider in deciding whether to modify Rochdale's aggregate credit threshold. As a result, MSET personnel twice increased Rochdale's aggregate credit threshold without appropriate due diligence to ensure that the credit increases were warranted.

15. Miller's Apple trades through MSET also generated 20 single order "soft" threshold alerts between 10:59 a.m. and 3:50 p.m. that day. (Nineteen single orders were above Rochdale's \$10,000,000 single order threshold and one single order contained an erroneous price entry.) MSET personnel allowed all 20 orders to be sent to the market within seconds of receiving each alert (e.g., the alert received at approximately 11:22:53 a.m. was released at approximately 11:23:02 a.m.).⁷ MS & Co.'s WSPs contained no criteria or guidance for MSET account representatives to consider in deciding whether to release single order soft threshold alerts.

⁶ MSET previously modified Rochdale's aggregate credit threshold on various dates before October 25, 2012: February 22, 2010, February 4, 2011, August 30, 2011, April 2, 2012, and April 3, 2012. The largest aggregate credit threshold increase during this period was April 2, 2012, when MSET increased Rochdale's net threshold from \$200 million to \$500 million (and then back to \$200 million on April 3). MS & Co. produced no documentation of any refusal by MSET to raise the aggregate credit threshold when confronted with a customer order to purchase equity securities in an amount that exceeded the threshold.

⁷ MSET previously modified Rochdale's single order threshold on six dates during 2009 and 2010. For example, on August 4, 2010, MSET increased Rochdale's single order threshold from \$10 million to \$25 million, and on December 9 and 10, 2010, from \$40 million to \$50 million. MSET typically coded these single order threshold increases as "due to increased client trading volume."

16. Neither the initial increase to Rochdale's aggregate credit threshold (from \$200 million to \$500 million) nor the numerous prior single order soft threshold alerts were considered by MSET personnel in connection with the second decision to increase Rochdale's aggregate credit threshold. Moreover, MSET's documented reason for increasing Rochdale's aggregate credit threshold on both occasions was "trading style," which was one of several choices in the drop-down menu. One MSET supervisor who confirmed Rochdale's aggregate credit threshold increases incorrectly believed MSET's credit thresholds were in place primarily to prevent against erroneous orders ("fat finger" errors).

17. Unbeknownst to MSET, the Rochdale customer on whose behalf Miller was purchasing Apple had purportedly authorized Miller to purchase only 1,625 shares. Miller's order for many multiples of what was written in Rochdale's customer order was in fact part of a fraudulent scheme to personally profit by sharing the anticipated proceeds with the customer if Apple's stock price increased following the earnings announcement. When Apple's stock price began dropping later that day, and it became clear that the trades would not be profitable, Miller falsely claimed that he had made a mistake.

18. As a result of Miller's actions, Rochdale purchased 1,625,000 shares of Apple. Rochdale promptly traded out of the position, but, as a result of the decrease in stock price, suffered a loss of approximately \$5.3 million by the following day. Regulatory net capital requirements prohibited Rochdale from continuing to trade securities, and Rochdale ceased all business operations in approximately February 2013.

VIOLATIONS

19. Section 15(c)(3) of the Exchange Act, among other things, prohibits a broker or dealer from effecting any securities transaction in contravention of the rules and regulations the Commission prescribes as necessary or appropriate in the public interest, or for the protection of investors, to provide safeguards with respect to the financial responsibility and related practices of brokers or dealers. MS & Co. violated this Section through its violations, described below, of a rule promulgated by the Commission thereunder.

20. Subsection (c)(1)(i) of Rule 15c3-5 requires that a broker or dealer's risk management controls and supervisory procedures shall be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit thresholds in the aggregate for each customer. The adopting release for the Market Access Rule explained that credit thresholds would be "based on appropriate due diligence as to the customer's business, financial condition, trading patterns, and other matters," that decisions on credit thresholds would be documented, and that "the Commission expects the broker-dealer will monitor on an ongoing basis whether the credit thresholds remain appropriate, and promptly make adjustments to them, and its controls and procedures, as warranted."⁸ MS & Co.'s controls and procedures, as reflected in its WSPs, were not reasonably designed to prevent the entry of orders that exceed pre-set aggregate credit thresholds for customers because they did not reasonably guide decisions regarding possible modifications of

⁸ 75 Fed. Reg. at 69802.

customer aggregate credit thresholds. As a result, MS & Co. twice increased Rochdale's aggregate credit threshold without appropriate due diligence to ensure that the credit increases were warranted.

21. Based on the foregoing, the Commission finds that MS & Co. willfully⁹ violated Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder.

REMEDIAL EFFORTS

22. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent MS & Co.'s Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent MS & Co. cease and desist from committing or causing any violations and any future violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder.

B. Respondent MS & Co. is censured.

C. Pursuant to Section 21B(a)(1) and (2) of the Exchange Act, Respondent MS & Co. shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$4,000,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Such payment must be made in one of the following ways: (1) Respondent MS & Co. may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) Respondent MS & Co. may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

⁹ A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Enterprise Services Center
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Payments by check or money order must be accompanied by a cover letter identifying MS & Co. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Daniel M. Hawke, Chief, Market Abuse Unit, Division of Enforcement, Securities and Exchange Commission, Philadelphia Regional Office, One Penn Center, 1617 JFK Boulevard, Suite 520, Philadelphia, PA 19103.

By the Commission.

Brent J. Fields
Secretary