

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 10290 / January 24, 2017**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17809**

**In the Matter of**

**MORGAN STANLEY  
SMITH BARNEY LLC,**

**Respondent.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT  
OF 1933, MAKING FINDINGS, AND  
IMPOSING A CEASE-AND-DESIST  
ORDER**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) against Morgan Stanley Smith Barney LLC (“MSSB” 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 Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, 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 finds<sup>1</sup> that:

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<sup>1</sup> 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. This proceeding relates to a foreign exchange trading program developed by Citigroup Global Markets, Inc. (“CGMI”) that was known as “CitiFX Alpha” and that was sold through certain MSSB financial advisors between August 2010 and July 2011. Fifteen investors (the “Relevant Investors”)—each of whom also had a pre-existing relationship with one of three MSSB financial advisors as a brokerage customer, advisory client, or both—invested in CitiFX Alpha following pitches that were based on CitiFX Alpha’s past performance and risk metrics. The pitches were made orally and used written materials prepared by CGMI. The written materials, however, were rendered materially misleading because they failed to adequately disclose that the Relevant Investors could be placed into the program using substantially more leverage than was disclosed and that mark-ups would be charged on each trade. The oral presentations made to the Relevant Investors contained these same omissions. When CGMI’s trading models began generating losses, the Relevant Investors suffered losses that were increased by the amount of leverage used and the undisclosed mark-ups.

## **Respondent**

2. MSSB is a limited liability company organized under the laws of Delaware with its principal office and place of business in Purchase, New York. MSSB (SEC File Nos. 801-70103 and 8-68191) has been registered with the Commission since May 2009 as both a broker-dealer and an investment adviser.

## **Other Relevant Entity**

3. CGMI is a corporation organized under the laws of New York, has its principal office and place of business in New York, New York, and is a wholly owned indirect subsidiary of Citigroup, Inc. At all relevant times, CGMI held a 49% ownership interest in MSSB. CGMI (SEC File Nos. 801-3387 and 8-8177) has been registered with the Commission since February 1964 as both a broker-dealer and an investment adviser.

## **Background**

### **The CitiFX Alpha Program**

4. Prior to the relevant time period, CGMI developed a variety of quantitative foreign exchange trading models, which it referred to as the CitiFX Alpha family of strategies. CGMI incorporated these models into various financial programs, including the program in which the Relevant Investors participated (the “CitiFX Alpha Program”). As it operated with respect to the Relevant Investors, the CitiFX Alpha Program constituted an investment contract.

5. The CitiFX Alpha Program included seven quantitative trading models that collectively generated trading signals for 16 currency pairs. CGMI generated the signals every morning and executed the trades shortly thereafter. The Relevant Investors did not play a role in generating the trading signals (such as by customizing the currencies they would trade or the models they would follow), and they often were not told about the signals before the trades were

executed. To the contrary, the CitiFX Alpha Program was marketed and offered as a way for the Relevant Investors to track CGMI's quantitative trading models, and the Relevant Investors were completely dependent on CGMI and its trading models to generate their profits.

6. Everyone enrolled in the CitiFX Alpha Program received proportionately identical signals. While investors could trade different notional amounts—that is, the size of the foreign exchange portfolio being traded could vary—the signals were identical in all other respects. The signals were not based on the Relevant Investors' financial situations or investment objectives. Nor were the Relevant Investors given the opportunity to place any restrictions that would affect the trade signals that they would receive or the trades that would be executed.

7. When the Relevant Investors enrolled in the CitiFX Alpha Program, they opened foreign exchange trading accounts at CGMI and posted either cash or securities to those accounts as collateral. Some of the Relevant Investors generated the cash that they used as collateral by selling securities in securities accounts at MSSB.

8. The Relevant Investors' MSSB financial advisors consulted with CGMI personnel in the process of selecting the notional amounts that the Relevant Investors traded. The amount of collateral that each of the Relevant Investors posted was less than the notional amount of the foreign exchange portfolio they traded. Some of the Relevant Investors posted collateral equal to as little as ten percent of their notional amount.

9. The Relevant Investors' MSSB financial advisors selected the size of the mark-ups CGMI charged on each CitiFX Alpha trade, using a range of mark-ups provided by CGMI personnel. CGMI and MSSB each received half of the mark-ups, and each thereby obtained money or property from the Relevant Investors.

#### Sales of the CitiFX Alpha Program

10. The CitiFX Alpha Program was sold through certain MSSB financial advisors beginning in August 2010.

11. CGMI personnel sold the CitiFX Alpha Program to the Relevant Investors both directly and indirectly. CGMI personnel first approached MSSB financial advisors and pitched the CitiFX Alpha Program to them. CGMI personnel and MSSB financial advisors then pitched the CitiFX Alpha Program to the Relevant Investors. In some instances, CGMI personnel led presentations in which MSSB financial advisors participated. In other instances, MSSB financial advisors pitched the CitiFX Alpha Program themselves using written materials, in PowerPoint format, that CGMI had created.

12. At sales pitches, CGMI personnel and MSSB financial advisors gave the Relevant Investors a copy of a PowerPoint presentation that CGMI had created about the CitiFX Alpha Program. CGMI personnel gave some of the Relevant Investors an oral presentation that tracked the contents of the PowerPoint presentation. Both the PowerPoint and the oral presentations focused on the CitiFX Alpha Program's past performance and risk metrics. These past performance and risk metrics assumed fully collateralized accounts—that is, accounts in which the

amount of collateral was equal to the notional amount being traded—and that no mark-ups would be charged on trades. Neither of these assumptions was adequately disclosed to investors.

13. The Relevant Investors included individuals who had no experience in foreign exchange trading and who did not understand what a notional amount is; that the cash they posted to their foreign exchange accounts merely served as collateral; or that there was a difference between the notional amounts they traded and the amount of collateral they posted to their accounts.

14. By pitching the CitiFX Alpha Program to the Relevant Investors based on its past performance and risk metrics, but failing to question those metrics, the MSSB financial advisors did not adequately disclose that these past performance and risk metrics did not reflect the degree of leverage that the Relevant Investors actually would employ, which would have materially altered the disclosed performance and risk metrics, and thus omitted material information necessary in order to make statements about the CitiFX Alpha Program not misleading.

15. In addition, by pitching the CitiFX Alpha Program to the Relevant Investors based on its past performance, but failing to question that performance, the MSSB financial advisors did not adequately disclose that the stated performance figures were gross of mark-ups or adequately disclose the amount of the mark-ups, which would have materially altered the disclosed performance figures, and thus omitted material information necessary in order to make statements about the CitiFX Alpha Program not misleading.

16. Following a compliance department review, MSSB placed certain restrictions on the program during the spring of 2011, and no new investors enrolled in the program after July 2011.

### **Violations**

17. As a result of the conduct described above, MSSB violated Section 17(a)(2) of the Securities Act, which prohibits any person in the offer or sale of a security from obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Negligence is sufficient to establish a violation of Section 17(a)(2) of the Securities Act.

### **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in MSSB's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act, Respondent MSSB cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act.

B. MSSB shall, within 21 days of the entry of this Order, pay disgorgement of \$624,458.27, prejudgment interest of \$89,277.34, and a civil money penalty in the amount of \$2,250,000 to the Securities and Exchange Commission. If timely payment of disgorgement and prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. If timely payment of the civil monetary penalty is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent 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:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying MSSB 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 Glenn S. Gordon, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Ave., Suite 1800, Miami, FL 33131.

C. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, prejudgment interest and penalties referenced in paragraph B above. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed

in this proceeding. For purposes of this paragraph, a “Related Investor Action” means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields  
Secretary