

NYSE ARCA, INC.

NYSE REGULATION,

Complainant,

v.

MORGAN STANLEY & CO. LLC,

Respondent.

Proceeding No. 20140430991¹

October 17, 2018

Morgan Stanley & Co. LLC violated: (i) Exchange Act Rule 611(c) of Regulation NMS and NYSE Arca Rule 7.31-E(e)(3), by submitting approximately 2,691 ISOs to the NYSE Arca Marketplace that may have traded through protected quotations; and (ii) NYSE Arca Rule 11.18, by failing to establish, maintain, and enforce supervisory systems and written procedures reasonably designed to prevent trade-throughs of protected quotations in NMS stocks that do not fall within an applicable exception and to otherwise achieve compliance with respect to applicable securities laws and regulations and NYSE Arca rules concerning Exchange Act Rule 611(c) of Regulation NMS. Consent to censure and \$8,900 fine.

Appearances

For the Complainant: Elyse D. Kovar, Esq., Eric S. Brown, Esq., and Andrew Beirne, Esq., FINRA Department of Enforcement.

For the Respondent: Samantha L. Schreiber, Esq., Morgan Stanley & Co. LLC.

DECISION

Morgan Stanley & Co. LLC (“Morgan Stanley” or “Firm”) and NYSE Arca, Inc. (“NYSE Arca” or “Exchange”) entered into an Offer of Settlement and Consent for the sole purpose of settling this disciplinary proceeding, without adjudication of any issues of law or fact, and without admitting or denying any allegations or findings referred to in the offer of settlement.² The

¹ Includes Proceeding Nos. 20150468009 and 20180575199.

² FINRA’s Office of Hearing Officers reviewed the Offer of Settlement and Consent under the terms of a Regulatory Services Agreement (as amended) among NYSE Group, Inc., New York Stock Exchange LLC, NYSE Arca, Inc., NYSE MKT LLC, and FINRA.

Hearing Officer accepts the Offer of Settlement and Consent and issues this Decision in accordance with NYSE Arca Rules.³

FINDINGS OF FACTS AND VIOLATIONS

Background and Jurisdiction

1. Morgan Stanley became registered as an Equities Trading Permit (“ETP”) Holder with NYSE Arca on July 29, 1974, and its registration remains in effect. The Firm has no relevant disciplinary history.
2. This matter involves three reviews the Department of Market Regulation’s Market Analysis Section (“Staff”) of the Financial Industry Regulatory Authority (“FINRA”) conducted on behalf of multiple self-regulatory organizations, including NYSE Arca, of Morgan Stanley’s compliance with Securities Exchange Act of 1934 (“Exchange Act”) Rule 611 of Regulation NMS (“Rule 611”), and Exchange rules governing the entry of Intermarket Sweep Orders (“ISOs”) into the NYSE Arca Marketplace, and related supervision requirements during an overall period between April 2014 and November 2017 (“ISO Review Period”). In Matter No. 20140430991, the Staff reviewed the Firm’s activity during the second quarter of 2014, later expanded through April 2015. In Matter No. 20150468009, the Staff reviewed the Firm’s activity during the period between January 2015 and September 2015, and identified an additional limited issue involving the Firm’s incorrect programming of a single security during the period between February 2015 and May 2017. In Matter No. 20150468009, the Staff reviewed the Firm’s activity during the period between January 2015 and September 2015, and identified an additional limited issue involving the Firm’s incorrect programming of a single security during the period between February 2015 and May 2017. In Matter No. 20180575199, the Staff reviewed the Firm’s activity in connection with an issue that had resulted from an upgrade to the Firm’s smart order router, which lasted for six weeks, between September 21, 2017, and November 9, 2017; the Firm self-identified and self-corrected the issue prior to the Staff’s review.
3. In letters dated September 16, 2016, June 9, 2017, August 21, 2017, and in subsequent correspondence in February and March 2018, which the Firm received, FINRA’s Department of Enforcement, on behalf of the Exchange, notified Morgan Stanley that it was investigating the Firm’s compliance with federal securities laws and rules and exchange rules relating to order protection, trade-throughs, ISOs and related supervision.

³ The facts, allegations, and conclusions contained in this Decision were taken from the executed Offer of Settlement and Consent. Prior to August 17, 2017, the rules involved in this matter were called NYSE Arca Equities rules.

Overview

4. This matter involves Morgan Stanley's compliance with federal securities laws and rules and exchange rules relating to order protection, trade-throughs, ISOs and related supervision during the ISO Review Period.

Violations

5. Rule 611 requires broker-dealers to take reasonable steps to establish that ISOs meet the requirements set forth in Exchange Act Rule 600(b)(30) of Regulation NMS ("Rule 600(b)(30)"). Rule 600(b)(30) defines an ISO as a limit order for an NMS stock that meets two requirements: (i) it is identified as an ISO; and (ii) the firm simultaneously routes additional limit orders, as necessary, to execute against the full displayed size of any protected quotes at a price that is superior to the limit price of the limit order. NYSE Arca Rule 7.31-E(e)(3)⁴ requires that ETP holders comply with Rule 611 with respect to ISOs.
6. NYSE Arca Rule 11.18(a) prohibits an ETP Holder from engaging in conduct in violation of the federal securities laws and the Constitution and Rules of NYSE Arca. Rule 11.18(b) requires each ETP Holder to "establish and maintain a system to supervise the activities of its associated persons and the operation of its business[.]" and that such system "must be reasonably designed to ensure compliance with applicable federal securities laws and regulations and NYSE Arca Rules."⁵
7. During the ISO Review Period, Morgan Stanley failed to take reasonable steps to establish that ISOs it routed met the definitional requirements set forth in Rule 600(b)(30), primarily due to systems issues, as follows: (i) a system issue with the Firm's automated smart order router technology, which resulted in the Firm's failure to record certain superior quotes before routing ISOs; (ii) a technology change by a market data vendor which, unbeknownst to the Firm, resulted in the Firm's failure to capture in its protected quote snapshot certain top of book quotations from certain protected market centers; (iii) the Firm's programming of a single security with an incorrect lot size; and (iv) the Firm's update to a subset of its smart order router technology on September 21, 2017, which, unbeknownst to the Firm, resulted in a failure to embed an ISO indicator on a subset of orders it had routed to certain other exchanges, and potential trade throughs of protected quotations on such other exchanges. The Firm self-identified this issue on October 30, 2017, and corrected it on November 9, 2017, prior to the commencement of the Staff's review.

⁴ During the ISO Review Period prior to August 17, 2017, the Exchange rule cited in paragraph five above was designated NYSE Arca Equities Rules 7.31(jj), 7.31(e)(2), and 7.31(e)(3).

⁵ During the ISO Review Period prior to August 17, 2017, the Exchange rule cited in paragraph six above was designated NYSE Arca Equities Rule 6.18.

8. As a result of the foregoing systems issues, Morgan Stanley routed approximately 2,691 ISOs to the NYSE Arca Marketplace that potentially traded through protected quotations in NMS stocks on other exchanges. Such conduct violated Rule 611(c) and NYSE Arca Rule 7.31-E(e)(3).
9. In addition, during the ISO Review Period, Morgan Stanley failed to establish, maintain, and enforce supervisory systems and written procedures reasonably designed to prevent trade-throughs of protected quotations in NMS stocks that do not fall within an applicable exception and to otherwise achieve compliance with respect to applicable securities laws and regulations and NYSE Arca rules concerning Rule 611(c). Among other things, Morgan Stanley's ISO surveillance report failed to take into account whether the order was cancelled or executed. Such conduct violated NYSE Arca Rule 11.18.

ORDER

Morgan Stanley & Co. LLC violated: (i) Exchange Act Rule 611(c) of Regulation NMS and NYSE Arca Rule 7.31-E(e)(3), by submitting approximately 2,691 ISOs to the NYSE Arca Marketplace that may have traded through protected quotations; (ii) NYSE Arca Rule 11.18, by failing to establish, maintain, and enforce supervisory systems and written procedures reasonably designed to prevent trade-throughs of protected quotations in NMS stocks that do not fall within an applicable exception and to otherwise achieve compliance with respect to applicable securities laws and regulations and NYSE Arca rules concerning Exchange Act Rule 611(c) of Regulation NMS.

SANCTIONS

Morgan Stanley & Co. LLC is censured and fined \$8,900.⁶

These sanctions are effective immediately.



David Williams
Hearing Officer

⁶ Under the Offer of Settlement and Consent, Morgan Stanley agreed to pay a total fine of \$62,300, of which \$8,900 shall be paid to NYSE Arca and the remaining amount shall be paid to FINRA, Cboe EDGX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe BZX Exchange, Inc., Cboe BYX Exchange, Inc., the New York Stock Exchange LLC, and Investors Exchange LLC.