



Financial Industry Regulatory Authority

Jacqueline Gorham  
Senior Counsel  
Department of Enforcement  
Jacqueline.Gorham@finra.org  
t 646 430 7044

**By: Certified Mail, Return Receipt Requested and Email**

August 23, 2018

Morgan Stanley & Co. LLC  
Mr. James J. Mangan  
Managing Director and Head of U.S. Litigation  
1585 Broadway  
New York, NY 10036

**RE: Payment of Fine in Connection with Executed Letter of Consent  
FINRA Matter No. 20120346239-04**

Dear Mr. Mangan:

Enclosed is an executed copy of the Letter of Consent ("LOC"), signed by you at Morgan Stanley & Co. LLC (the "Firm"), and countersigned by Edward Deitzel, Executive Vice President and Chief Regulatory Officer, for the Business Conduct Committee, at the Miami International Securities Exchange, LLC ("MIAX" or the "Exchange") on August 22, 2018. Please consider this correspondence as notice to the Firm that this LOC has been accepted, and as a result, the Firm must promptly remit payment of the agreed upon sanction. Please make the payment to Miami International Securities Exchange, LLC.

The payment should be sent to the below address if payment is by check:

MIAX Options  
Attn: Tia Toms  
7 Roszel Road, Suite 5A  
Princeton, NJ 08540  
Reference Number: Matter No. [Insert STAR Number]

If payment is by wire, wiring instructions are as follows:

August 23, 2018

Page 2

Pursuant to MIAX Rule 1011, after seven calendar days' notice in writing, the Exchange may summarily suspend a Member that fails to pay promptly a fine when such fine becomes finally due and payable.

If you have any questions concerning this matter, please contact me at (646) 430-7044.

Sincerely,



Jacqueline Gorham  
Senior Counsel  
Department of Enforcement, FINRA

Enclosure

cc: Larry O'Leary, VP Regulation, Miami International Securities Exchange, LLC  
(via e-mail to [lolareary@miaxoptions.com](mailto:lolareary@miaxoptions.com))

FINRA District 10 – New York  
Michael Solomon  
Senior Vice President and Regional Director  
(Via email)

Wayne M. Aaron  
Milbank, Tweed, Hadley & McCloy LLP  
28 Liberty Street  
New York, NY 10005  
Counsel for Respondent

*This letter is issued on behalf of the Miami International Securities Exchange, LLC, by FINRA Department of Enforcement pursuant to a grant of authority to FINRA. Accordingly, this constitutes a letter by the Miami International Securities Exchange, LLC.*

**MIAMI INTERNATIONAL SECURITIES EXCHANGE, LLC**  
**LETTER OF CONSENT**  
**NO. 20120346239-04**

**TO: Miami International Securities Exchange, LLC**  
**c/o Department of Enforcement**  
**Financial Industry Regulatory Authority ("FINRA")**

**RE: Morgan Stanley & Co. LLC ("MSCO"), Respondent**  
**Broker-Dealer**  
**CRD No. 8209**

Pursuant to Rule 1003 of the Rules of the Miami International Securities Exchange, LLC ("MIAX"), Morgan Stanley & Co. LLC (the "Firm") submits this Letter of Consent ("LOC") for the purpose of proposing a settlement of the alleged rule violations described below. This LOC is submitted on the condition that, if accepted, MIAX will not bring any future actions against the Firm alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. The Firm 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 MIAX, or to which MIAX 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 MIAX:

**BACKGROUND**

1. MSCO, a wholly-owned subsidiary of Morgan Stanley Domestic Holdings, Inc., is a Delaware limited liability company headquartered in New York, New York. The Firm provides services to corporate and broker-dealer clients and institutional investors, and acts as an agency broker-dealer, providing market access and execution services to market participants ("Market Access Clients") for a wide variety of products.
2. The Firm became a member of MIAX on December 7, 2012, and a member of FINRA on June 5, 1970, and its registrations remain in effect. The Firm does not have a relevant disciplinary history.

**Summary**

3. In Matter No. 20150443070, the Options Regulation staff of FINRA's Department of Market Regulation ("Market Regulation"), on behalf of MIAX, reviewed an erroneous order event that occurred on MIAX on July 25, 2014, and the Firm's risk management controls and supervisory procedures for compliance with Rule 15c3-5 of the Securities

Exchange Act of 1934 (“SEA”) (the “Market Access Rule”).<sup>1</sup>

4. The above matter was one of several investigations, which included Matter No. 20120346239, conducted by Market Regulation on behalf of MIAX and other self-regulatory organizations, including Cboe BZX Exchange, Inc., Cboe BYX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., FINRA, The NASDAQ Stock Market LLC, New York Stock Exchange, Inc., and NYSE Arca, Inc. (collectively, the “SROs”), to review the Firm’s compliance with the Market Access Rule and the supervisory rules of the relevant SROs, including MIAX Rules 500(b) and 1308(c), during the period of July 14, 2011 through July 2017 (the “Review Period”).
5. As a result of Market Regulation’s investigations, it was determined that, during the Review Period, MSCO failed to establish, document, and maintain a system of risk management controls and supervisory procedures, including written supervisory procedures and an adequate system of follow-up and review, reasonably designed to manage the financial, regulatory, and other risks of its market access business.
6. Specifically, during the Review Period, the Firm failed to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders by rejecting orders that exceed appropriate price or size parameters, or that indicate duplicative orders, in violation of SEA Rules 15c3-5(b) and (c)(1)(ii), and MIAX Rules 500(b) and 1308(c).

## **FACTS AND VIOLATIVE CONDUCT**

### **Applicable Rules**

7. During the Review Period, SEA Rule 15c3-5(b) required broker-dealers that provide market access to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of their market access business.<sup>2</sup>
8. During the Review Period, SEA Rule 15c3-5(c)(1)(ii) required market access broker-dealers to have financial risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders.
9. During the Review Period, MIAX Rule 500(b), prohibited members from engaging in conduct (1) inconsistent with the maintenance of a fair and orderly market; (2) apt to impair public confidence in the operations of the Exchange; or (3) inconsistent with the

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<sup>1</sup> The SEC adopted Rule 15c3-5 effective July 14, 2011. See 17 C.F.R. § 240.15c3-5, *Risk Management Controls for Brokers or Dealers with Market Access*, 75 Fed. Reg. 69792 (Nov. 15, 2010) (Final Rule Release).

<sup>2</sup> Rule 15c3-5 requires that broker-dealers providing market access must “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.” 75 Fed. Reg. at 69792.

ordinary and efficient conduct of business. MIAX Rule 1308(c)(1) required members to develop and maintain adequate controls over each of its business activities, and that such controls must provide for the establishment of procedures for verification and testing of those business activities.

#### **Overview of MSCO's Market Access Systems**

10. During the Review Period, MSCO provided and maintained market access and executed millions of trades per day for its Market Access Clients.
11. During the Review Period, MSCO had a number of different Divisions through which orders were sent to various markets. These Divisions included the Firm's Institutional Equities Division, which conducted traditional agency and principal business, and offered electronic trading services to its Market Access Clients.
12. During the Review Period, MSCO used a variety of systems (e.g., order management systems, algorithms, etc.) through which its Market Access Clients and traders entered orders for routing to and execution on various U.S. securities markets, including the SROs. Those systems contained controls to which the orders submitted were subjected. In addition, MSCO assigned and applied various controls to individual Market Access Clients and traders to which orders submitted by those clients and traders were subjected before submission to the various markets.
13. MSCO generally implemented one or more of the following pre-trade controls: a duplicate order control; a single order notional control (i.e., the value of an order, which is generally calculated by multiplying the share price by the amount of shares); a single order quantity control; a liquidity control (i.e., a percentage of the estimated daily volume in a symbol); an average daily trading volume ("ADTV") control; and a tick away limit. The combination of controls and the limits at which these controls were set varied depending upon the Market Access Client or Firm trader.

#### **Inadequate Options Pre-Trade Erroneous Order Controls**

14. Despite the various pre-trade controls that the Firm had in place during the Review Period that were designed to prevent the entry of erroneous orders, the Firm failed to implement reasonably designed pre-trade risk management controls applicable to orders submitted by certain Market Access Clients in certain circumstances, and failed to establish and implement supervisory procedures reasonably designed to prevent the entry of potentially erroneous orders during the Review Period, as set forth below.
15. Because MSCO's pre-trade controls were not reasonably designed as applied to certain of the Firm's Market Access Clients, MSCO did not prevent the transmission of certain erroneous equity and options orders to the SROs or to the Exchange, causing 54 erroneous order events (53 for equities and one for options) resulting in one trading halt and one request for a voluntary bust. The erroneous equity order events caused price movement in the related securities, including movement of up to 77% in one instance, and the erroneous option order event caused price movement in the related security of 98%.

16. For options orders sent to the Exchange during the Review Period, MSCO had certain pre-trade controls, which included single order quantity, single order notional, and tick away limit controls, duplicative order check, liquidity, and market impact price controls.
17. As a result of a deficiency in the Firm's market impact price control, on July 25, 2014, the Firm did not prevent the entry of erroneous orders on MIAX in "ABC"<sup>3</sup> put contracts that were entered by a Market Access Client ("CD"),<sup>4</sup> which caused the price of ABC to drop by 98% within 13 seconds. The Firm's market impact price control required both a minimum price movement of \$1 and a certain percentage in order to flag an order. Thus, a price movement of up to but less than \$1 would not be flagged even if it exceeded the applied percentage. CD's orders in ABC were not flagged because the required \$1 movement did not occur as the option was priced under \$1. Thus, the Firm's control did not effectively apply to options priced under \$1.<sup>5</sup>

18. The acts, practices, and conduct described above in paragraphs 14 through 17 constitute violations of SEA Rules 15c3-5(b) and (c)(1)(ii), and MIAX Rules 500(b) and 1308(c).

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

1. A censure; and
2. A total fine in the amount of \$1,100,000, of which \$35,000 is payable to MIAX.<sup>6</sup>
3. Acceptance of this AWC is conditioned upon acceptance of similar settlement agreements in related matters between the firm and each of the following self-regulatory organizations: Cboe BZX Exchange, Inc., Cboe BYX Exchange, Inc., Cboe EDGX Exchange, Inc., Cboe EDGA Exchange, Inc., FINRA, The NASDAQ Stock Market LLC, New York Stock Exchange, LLC, and NYSE Arca, Inc.

The Firm agrees to pay the monetary sanction(s) upon notice that this LOC has been accepted and that such payment(s) are due and payable. It has submitted an Election of Payment 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(s) imposed in this matter.

The sanctions imposed herein shall be effective on a date set by MIAX.

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<sup>3</sup> A generic identifier has been used in place of the name of this security.

<sup>4</sup> A generic identifier was used in place of the name of this client.

<sup>5</sup> The Firm remediated this issue by lowering the parameters on August 18, 2014, and further lowering the parameters on December 1, 2015.

<sup>6</sup> The balance of the sanction will be paid to the self-regulatory organizations listed in Paragraph B.3.

## **II.**

### **WAIVER OF PROCEDURAL RIGHTS**

**The Firm specifically and voluntarily waives the following rights granted under MIAX Rules:**

- A. To have a Statement of Charges issued specifying the allegations against the Firm;**
- B. To be notified of the Statement of Charges 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 MIAX's Board of Directors 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 prejudgment of the Chief Regulatory Officer ("CRO"), as well as the Business Conduct Committee ("BCC"), in connection with participation in discussions regarding the terms and conditions of this LOC, or other consideration of this LOC, including acceptance or rejection of this LOC.**

**The Firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of MIAX Rule 1006, in connection with such person's or body's participation in discussions regarding the terms and conditions of this LOC, or other consideration of this LOC, including its acceptance or rejection.**

## **III.**

### **OTHER MATTERS**

**The Firm understands that:**

- A. Submission of this LOC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the CRO and the BCC, pursuant to MIAX Rule 1003;**
- B. If this LOC 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 LOC will become part of the firm's permanent disciplinary record and may be considered in any future actions brought by MIAX or any other regulator against the Firm;**
  - 2. this AWC will be published on a website maintained by MIAX; 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 LOC or create the impression that the LOC is without factual basis. The Firm may not take any position in any proceeding brought by or on behalf of MIAX, or to which MIAX is a party, that is inconsistent with any part of this LOC. Nothing in this provision affects the firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which MIAX is not a party.**
- D. The Firm may attach a Corrective Action Statement to this LOC 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 LOC in this Statement. This Statement does not constitute factual or legal findings by MIAX, nor does it reflect the views of MIAX or its staff.**


**[Continued on next page]**



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 LOC and has been given a full opportunity to ask questions about it; that it has agreed to the LOC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Statement of Charges, has been made to induce the Firm to submit it.

Date: 5/22/2018

Morgan Stanley & Co. LLC, Respondent

By:   
Name: James J. Mangum  
Title: Counsel to Morgan Stanley & Co LLC

Reviewed by:

  
Wayne M. Aaron  
Milbank, Tweed, Hadley  
& McCloy LLP  
28 Liberty Street  
New York, NY 10005  
(212) 530-5000  
Counsel for Respondent

Accepted by Miami International Securities Exchange, LLC:

8/22/18  
Date

  
Edward Deitzel  
Executive Vice President and  
Chief Regulatory Officer  
Miami International Securities Exchange, LLC

Decision of the Business Conduct Committee:

Accept  Decline

8/22/18  
Date

  
By: Edward Deitzel  
For the Business Conduct Committee

**ELECTION OF PAYMENT FORM**

The Firm intends to pay the fine proposed in the attached Letter of Consent by the following method (check one):

- A Firm check or bank check for the full amount;
- Wire transfer;

Morgan Stanley & Co. LLC, Respondent

5/29/2018  
Date

By: [Signature]  
Name: Thomas J. Mangano  
Title: Counsel to Morgan Stanley & Co LLC