



DIVISION OF
CORPORATION FINANCE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

June 29, 2018

Elizabeth A. Marino, Esq.
Sidley Austin LLP
60 State Street
36th Floor
Boston, MA 02109

**Re: In the Matter of Morgan Stanley Smith Barney LLC
Waiver of Disqualification pursuant to Rule 506(d)(2)(ii) of Regulation D
Exchange Act Release No. 34-83571, June 29, 2018
Administrative Proceeding File No. 3-18566**

Dear Ms. Marino:

This letter responds to your letter dated June 29, 2018 (“Waiver Letter”), written on behalf of Morgan Stanley Smith Barney LLC (“MSSB”), and constituting an application for a waiver of disqualification under Rule 506(d)(2)(ii) of Regulation D under the Securities Act of 1933. In the Waiver Letter, you requested relief from the disqualification that arises by virtue of the Commission’s order entered June 29, 2018, in the Matter of Morgan Stanley Smith Barney LLC pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Release No. 34-83571 (the “Order”).

Based on the facts and representations in the Waiver Letter and assuming MSSB complies with the Order, we have determined that MSSB has made a showing of good cause under Rule 506(d)(2)(ii) of Regulation D that it is not necessary under the circumstances to deny reliance on Regulation D by reason of the entry of the Order. Accordingly, the relief requested in the Waiver Letter regarding the disqualification that would arise as to MSSB by reason of the entry of the Order is granted on the condition that MSSB fully complies with the terms of the Order. Any different facts from those represented or failure to comply with the terms of the Order would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

Sincerely,

/s/ Elizabeth M. Murphy

Elizabeth M. Murphy
Associate Director
Division of Corporation Finance



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AMERICA • ASIA PACIFIC • EUROPE

June 29, 2018

By Email and Overnight Courier

Timothy Henseler, Esq.
Chief, Office of Enforcement Liaison
Division of Corporation Finance
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 Smith Barney LLC (“MSSB”) in connection with the 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 15(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the “Order”) against MSSB.

On behalf of MSSB, we hereby respectfully request a waiver of any disqualification that will arise pursuant to Rule 506 of Regulation D under the Securities Act of 1933 (the “Securities Act”) with respect to MSSB or any of its affiliates as a result of the entry of the Order.

BACKGROUND

MSSB has engaged in settlement discussions with the Division of Enforcement in connection with the above-referenced administrative proceeding. As a result of these discussions, 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 out of (i) MSSB’s failure to adopt policies and procedures reasonably designed to prevent MSSB personnel from misusing and misappropriating funds in client accounts, from at least 2009 to the present, by permitting investment adviser representatives and registered representatives (referred to as “FAs”) to initiate third-party

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disbursements from client accounts of outgoing wire transfers and journals of up to \$100,000 per day per account based on the FA's attestation on an internal electronic form that the FA had received a verbal request from the client by phone or in-person and providing certain details about the request; and (ii) MSSB's failure to detect or prevent a FA from misappropriating funds from client accounts over an approximate one year period resulting in a failure reasonably to supervise the FA.

The Order will find that MSSB (i) willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and (ii) failed reasonably to supervise one FA, within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing his violations of the federal securities laws.

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 Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, (ii) be censured, (iii) pay a civil money penalty in the amount of \$3.6 million, and (iv) comply with certain undertakings enumerated in the Order.

DISCUSSION

MSSB understands that, absent a waiver, the entry of the Order will disqualify it, affiliated entities, and certain other issuers from relying on Rule 506 of Regulation D under the Securities Act. MSSB is concerned that, if it or its affiliates are deemed to be an issuer, predecessor of an issuer, affiliated issuer, general partner or managing member of an issuer, or promoter of securities, or if it is deemed to be acting in any other capacity described in Rule 506 for purposes of Rule 506(d)(1), then MSSB, its affiliates, and third parties that engage MSSB and its affiliates to act in (or otherwise involve MSSB in) one of the listed capacities in connection with their securities offerings would be prohibited from relying on Rule 506.

The Commission has the authority to waive this disqualification upon a showing of good cause that such disqualification is not necessary under the circumstances.¹ MSSB requests that the Commission do so here, on the following grounds:

¹ See Rule 506(d)(2)(i).

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1. *The Violations in the Order Do Not Arise Out of the Offer or Sale of Securities*

The Order arises solely out of the duties of a registered investment adviser, not the offer or sale of securities. Specifically, the conduct described in the Order arises out of MSSB's failure to adopt policies and procedures reasonably designed to prevent MSSB personnel from misusing and misappropriating funds in client accounts, which contributed to its failure to prevent or detect one FA from misappropriating funds from client accounts. The Order will find that while MSSB policies provided for certain reviews prior to issuing the disbursements, such reviews were not reasonably designed to detect or prevent a FA from making false attestations about having received a verbal client request to transfer funds to a third-party for the FA's benefit. The Order will also find that MSSB failed reasonably to supervise the above referenced FA. As described herein and as noted in the Order, MSSB has developed significant enhancements to its policies and procedures, systems and controls relating to preventing or detecting conversion of client advisory and customer brokerage funds by MSSB personnel through third-party cash disbursements (the "Enhanced MSSB Policies"), increased its anti-fraud program expenditures, and hired additional fraud operations personnel.

2. *The Misconduct Does Not Involve Violations of Section 5 of the Securities Act or Scier-ter-Based Statutory or Regulatory Provisions and Does Not Involve a Criminal Proceeding*

The violations in the Order are not criminal in nature and do not involve scier-ter-based fraud or violations of Section 5 of the Securities Act.

3. *MSSB Has Taken Remedial Steps and Will Take Additional Steps*

MSSB has taken substantial remedial steps, on its own initiative, to address the conduct at issue in the Order and it will take additional remedial steps to comply with the undertakings enumerated in the Order.

As noted in the Order, a representative of the defrauded clients contacted MSSB questioning transactions in their accounts. MSSB promptly conducted an internal investigation, terminated the FA and reported the fraud to the SEC and other law enforcement agencies. MSSB entered into settlement agreements with the defrauded clients in which MSSB fully repaid the clients plus interest. As noted above, MSSB has developed the Enhanced MSSB Policies, increased its anti-fraud program expenditures and hired additional fraud operations personnel. The Enhanced MSSB Procedures include increased client contact, independent client call backs

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on a risk-based and randomly-sampled basis, revisions to the calibration of its fraud software, and other new or revised internal surveillance procedures. In particular, MSSB:

- More than tripled the headcount of its Fraud Operations Department;
- Expanded its governance structure for fraud risk management and anti-fraud procedures;
- Instituted a Global Anti-Fraud Policy, which sets forth the obligations of employees, supervisors, and business units in fraud prevention and escalation and codifies the governance structure;
- Developed procedures that are specifically intended to prevent the misuse of procedures that permit clients to transfer money using verbal instructions and that are the subject of the Order;
- Launched a firm-wide fraud awareness training;
- Launched a set of surveillance triggers designed to identify potential warning signs of internal fraud; and
- Instituted monitoring of and increased controls over access to online client accounts.

In connection with the Order, MSSB also will agree to implement certain undertakings including the following:

- **Initial Certification:** Within six (6) months of the date of the Order, MSSB shall require the Head of Risk for Wealth Management (the “Certifying Individual”) to certify that the Enhanced MSSB Policies are fully operational (the “Initial Certification”). The Initial Certification shall be supported by exhibits sufficient to demonstrate compliance with the undertaking. The Commission staff may make reasonable requests for further evidence of compliance, and MSSB has agreed to provide such evidence.
- **Final Certification.** Within six (6) months after the date of the Initial Certification, MSSB has agreed to assess the implementation and adequacy of the Enhanced MSSB Policies, together with any other relevant MSSB policies, procedures, systems and controls relating to preventing or detecting conversion of client advisory funds by MSSB personnel through all forms of third-party cash disbursements (including but not limited to, wire transfer, journal or checks) (collectively, the “Then-Existing Relevant MSSB Policies”). MSSB shall require the Certifying Individual to certify that he or she has reviewed and evaluated MSSB’s

assessment and that, after reasonable inquiry, believes that the Then-Existing Relevant MSSB Policies are adequate and sufficient to provide reasonable assurance of compliance with all relevant Commission regulations and any standards and rules of self-regulatory organizations registered with the Commission and of which MSSB is a member (the “Final Certification”). If the Certifying Individual cannot represent that the Then-Existing Relevant MSSB Policies are adequate and sufficient, then the Certifying Individual shall describe in reasonable detail the reasons for the inability to so certify. In any event, MSSB must provide the Final Certification to the Commission staff within ninety (90) days of the end of the six-month period. The Final Certification shall also describe the nature and scope of MSSB’s assessment and be supported by exhibits sufficient to demonstrate compliance with the undertaking. The Commission staff may make reasonable requests for further evidence of compliance, and MSSB has agreed to provide such evidence.

MSSB thus has taken and will continue to take concrete steps to remediate the conduct at issue in the Order. The steps are designed to enhance MSSB’s overall compliance program going forward. Accordingly, it is not necessary to disqualify MSSB and its affiliates from relying on Rule 506 in connection with an offering.

4. *No Individuals Associated with MSSB Were Charged With Any Violations in Connection with the Order*

The Commission has not sought to charge any individuals currently 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’s former FA was responsible for the misconduct at issue. Upon learning of the FA’s misconduct, MSSB promptly terminated the FA.

5. *Nature and Duration of the Misconduct*

The conduct described in the Order arises out of MSSB’s failure, from 2009 to 2016, to adopt policies and procedures reasonably designed to prevent MSSB personnel from misusing and misappropriating funds in client accounts, which contributed to its failure to prevent or detect one FA from misappropriating funds from client accounts. The Order will find that while MSSB policies provided for certain reviews prior to issuing the disbursements, such reviews were not reasonably designed to detect or prevent an FA from making false attestations about having received a verbal client request to transfer funds to a third-party for the FA’s benefit. The Order will also find that MSSB failed reasonably to supervise the FA. As discussed above, the compliance policy at issue has been enhanced and MSSB has also hired additional fraud operations personnel.

The FA's misconduct occurred over a period of nearly a year. Upon learning of the FA's misconduct, MSSB promptly terminated the FA.

6. *Disqualification Would Have a Material and Disproportionate Impact on MSSB and its Clients*

MSSB's inability to act as a placement agent or compensated solicitor for Rule 506 offerings would have a significant adverse impact on clients and would be extremely damaging to MSSB, its affiliates, including Morgan Stanley Investment Management ("MSIM"), on funds sponsored, administered and/or advised by MSSB affiliates, funds managed by third parties (collectively, the "Funds"), and issuers of Private Placements (defined below) that have retained, or in the future may retain MSSB in connection with transactions that rely on exemptions under Rule 506(b) or (c).

MSSB currently acts, and in the future desires to continue to act, as (a) a "placement agent" for private placements of securities offered by affiliate and third-party issuers ("Private Placements"), and (b) a compensated solicitor pursuant to Fund selling agreements.

A. Effects of Disqualification on MSSB Alternative Investments Business

The alternative investments business at MSSB consists of the marketing and distribution of private funds such as exchange funds, managed futures, single manager hedge funds, fund of funds, private equity funds and real estate funds. The MSSB alternative investments business has approximately \$67 billion assets under management ("AUM") and the Rule 506 business constitutes nearly 88% of the AUM. The MSSB alternative investments business employs approximately 45 dedicated professionals and dozens of additional "service provider" employees. If MSSB were disqualified from acting as a compensated solicitor or placement agent for offerings relying on Rule 506, many, if not all, such professionals would lose their jobs and MSSB may be forced to exit its alternative investments business.

The alternative investments business continues to grow year over year and MSSB has increased the number of funds added to its platform each year since 2013. MSSB currently acts as a compensated solicitor and/or placement agent for approximately 180 open funds and engages with approximately 500 asset management partners. For the period January 2012 to March 2018, MSSB offered approximately 650 unique funds issued in reliance on Rule 506, and such Funds raised approximately \$50 billion from MSSB investors.² MSSB also offers over 50

² In addition to the 600 unique Funds issued in reliance on Rule 506, MSSB may have also offered for sale other Funds relying on Rule 506 that did not generate any sales.

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new funds, on average, each year. As of March 2018, MSSB is working on approximately 30 funds for which it expects to act as a compensated solicitor within the next six months.

Since 2012, MSSB has also served as placement agent, and provided access to alternative investments for wealth management clients such as individuals, trusts, family offices, pension funds, endowments and non-taxable retirement plans, in debt and equity offerings that raised approximately \$60 billion from MSSB accounts. As placement agent, MSSB works cooperatively with issuers to structure the Private Placements and the majority of such issuers prefer to offer their securities in reliance on Rule 506 rather than Section 4(a)(2) of the Securities Act. Reliance on Rule 506 is generally preferred over Section 4(a)(2) of the Securities Act due to the clearly delineated exemption criteria outlined in Rule 506 and related clarity regarding the universe of permissible clients in an offering made in reliance on Rule 506.

MSSB is also the sole distributor for its wealth management proprietary feeder fund business for wealth management clients. Each of the feeder funds is formed solely for the purpose of investing in an affiliate or third party managed private fund and relies on Rule 506. For certain of the feeder funds, such funds cannot conduct an offering under Section 4(a)(2) of the Securities Act given that the underlying funds often elect to rely on Regulation D and are also unable to utilize a distributor that is unable to participate in an offering made in reliance on Regulation D. MSSB clients are the sole investors in the feeder funds. If MSSB were disqualified pursuant to Rule 506, the clients invested in the feeder funds would be negatively and disproportionately impacted.

Fees to MSSB from fund sales, including placement agent fees, are approximately \$2.7 billion from January 2012 to March 2018, and cumulative fees associated with Fund sales that were issued in reliance on Rule 506 are approximately \$2.2 billion. Fees associated with Fund sales that were issued in reliance on Rule 506 constitute approximately 82% of the alternative investments business and approximately 2% of the total Morgan Stanley Wealth Management business.

B. Effect of Disqualification on MSSB Clients

As referenced above, alternative investments offered pursuant to Rule 506 are an integral part of MSSB's product offerings to clients. Approximately 9,500 MSSB financial advisors have clients holding at least one alternative investment position in their portfolios. Incorporating alternative investments into a traditional portfolio can help clients reduce overall volatility while increasing portfolio diversification, with a typically lower correlation to the market movements of traditional investments such as stocks and bonds. MSSB offers access to proprietary, affiliated and third-party Funds to approximately 400,000 MSSB households with a combined

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net worth of approximately \$1.8 trillion³ across approximately 100,000 accounts in Funds sold by MSSB. As demonstrated by the number of high net worth clients investing in Funds and Private Placements through their MSSB accounts, access to such products is very important to high net worth investors and allows such investors the ability to diversify their holdings in unique ways.

As the needs of such eligible investors and market conditions change, MSSB needs to be able to offer eligible investors new products that might more closely suit their investment objectives and current needs. If MSSB were disqualified from offering such Funds and Private Placements to its clients, clients would lose access to the types of Funds they may have accessed in the past or wish to access in the future. As a consequence, such clients may not be able to invest their portfolios as they and/or their financial advisors may see fit and, as such, may need to open new accounts at other broker-dealers or move their accounts to other brokerage firms that can offer such products to them.

Moving accounts to other brokerage firms can be very burdensome and harmful to clients because clients may hold positions that may not be easily transferred to other brokerage firms. Therefore, absent a waiver, clients would be forced to choose between maintaining multiple brokerage accounts, which many clients, especially high net worth clients, do not want to do for a variety of reasons, or lose access to products that would otherwise be in their best interests to meet their investment objectives and goals. For example, those clients invested in MSSB feeder funds may not have the ability to hold their positions outside of Morgan Stanley.

Finally, there would be commercial harm to MSSB if such clients (and their financial advisors) moved to other brokerage firms.

C. Effects of Disqualification on MSIM and MSIM Funds

MSSB is the primary distributor for MSIM funds and is the main retail channel for MSIM funds. MSSB client alternative fund assets currently account for approximately \$14 billion of MSIM's AUM. The majority of the MSIM alternative funds offered by MSSB are sold in reliance on the exemption under Rule 506.

If MSSB were disqualified pursuant to Rule 506, it would be unable to act as a compensated solicitor of any funds offered pursuant to Rule 506 and, therefore, the MSIM alternative funds would be disqualified from retaining MSSB as its compensated solicitor in

³ MSSB offers Private Placements and Funds to its qualified high net worth and institutional clients. The clients to whom MSSB offers the Funds are all accredited investors.

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connection with an offering made in reliance on Rule 506. Since MSSB is the main retail channel for the MSIM alternative funds, such funds would lose access to most of their retail investors, which represent a significant number of their investors. Currently, approximately 40,000 unique MSSB accounts hold investments in MSIM funds.⁴ Although MSSB would technically be permitted to act as a compensated solicitor of funds offered in reliance on Section 4(a)(2) of the Securities Act, the MSIM alternative funds would not likely be willing to offer their securities pursuant to Section 4(a)(2) due to the restrictions related to such offerings. MSIM's inability to use MSSB as its compensated solicitor would be detrimental to MSIM and the MSIM alternative funds.

7. *Provision of Written Description of Administrative Order*

If this requested waiver is granted, until MSSB provides all of the certifications to the Commission staff described above and detailed in the Order, MSSB agrees to furnish (or cause to be furnished) to each purchaser in a Rule 506 offering that would otherwise be subject to the disqualification under Rule 506(d)(1) as a result of the Order, a description in writing of the Order a reasonable time prior to sale.

REQUEST FOR WAIVER

In light of the nature of the violations in the Order, the enforcement remedies that already will be obtained by entry of the Order, the remedial measures MSSB has taken and will take, and the fact that the disqualification would have a material and disproportionate negative impact on MSSB's Rule 506 business, MSSB clients and MSSB affiliates, MSSB respectfully submits that it has shown good cause that relief from the Rule 506 disqualification should be granted.

Accordingly, we respectfully urge the Division, on behalf of the Commission, or the Commission, pursuant to Rule 506(d)(2)(ii), to waive the disqualification provisions in Rule 506 under the Securities Act to the extent they may be applicable to MSSB and its affiliates as a result of the entry of the Order.⁵

⁴ Please note that each account may hold positions in more than one MSIM fund.

⁵ The Commission has granted relief under Rule 506 of Regulation D for similar reasons or in similar circumstances: *See In the Matter of Citigroup Global Markets Inc.* (Jan. 26, 2017); *In the Matter of Morgan Stanley Smith Barney LLC* (Jan. 13, 2017); *In the Matter of Pacific Investment Management Company LLC* (Dec. 1, 2016); *In the Matter of Moloney Securities Co., Inc., et al.* (Sept. 30, 2016); *In the Matter of Felit & Company, Inc.* (June 21, 2016); *In the Matter of Royal Alliance Associates, Inc., et al.* (Mar. 14, 2016); *In the Matter of Barclays Capital Inc.*, Rel. No. 10011 (Jan. 31, 2016); *In the Matter of National Asset Management, Inc.* (Oct. 26, 2015); *In the Matter of Citigroup Global Markets, Inc.*, Rel. No. 9895 (Aug. 19, 2015); *Guggenheim Partners Investment Management, LLC* (Aug. 5,

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We appreciate your consideration of this request. Please feel free to contact me with any questions.

Very truly yours,


Elizabeth A. Marino

2015); *Merrill Lynch, Pierce, Fenner & Smith and Merrill Lynch Professional Clearing Corp.* (June 1, 2015); *BlackRock Advisors, LLC* (Apr. 20, 2015); *H.D. Vest Investment Securities, Inc.* (Mar. 4, 2015); *Barclays Capital Inc.*, Rel. No. 33-9651 (Sept. 23, 2014); *Wells Fargo Advisers, LLC*, Rel. No. 33-9649 (Sept. 22, 2014); *Dominick & Dominick LLC*, Release No. 33-9619 (July 28, 2014); *Jefferies LLC*, (Mar. 12, 2014); *Credit Suisse Group AG* (Feb. 21, 2014); *Instinet, LLC* (Dec. 26, 2013). MSSB is not requesting a waiver of the disqualification from relying on Regulation A at this time because it does not now use or participate in transactions under such offering exemption. MSSB understands that it may request such waivers in a separate request if circumstances change.