

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 86988 / September 17, 2019

INVESTMENT ADVISERS ACT OF 1940
Release No. 5354 / September 17, 2019

ADMINISTRATIVE PROCEEDING
File No. 3-19467

In the Matter of

Morgan Stanley Smith Barney, LLC,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND
CEASE-AND-DESIST
PROCEEDINGS PURSUANT TO
SECTIONS 15(b), 15B(c), AND 21C
OF THE SECURITIES EXCHANGE
ACT OF 1934 AND SECTION 203(e)
OF THE INVESTMENT ADVISERS
ACT OF 1940, MAKING FINDINGS,
AND IMPOSING REMEDIAL
SANCTIONS AND 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), 15B(c), and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 203(e) of the Investment Advisers Act of 1940 (“Advisers 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 (“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), 15B(c), and 21C of the Securities Exchange

Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and 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:

Summary

1. This matter involves violations of Municipal Securities Rulemaking Board (“MSRB”) rules by MSSB. Between June 2013 and December 2017, MSSB recommended 135 “swap” transactions to its retail customers in which the customer sold one municipal bond while also purchasing another bond that was nearly identical to the bond sold or that otherwise appeared to provide no apparent economic benefit to the customer. While MSSB’s policies and procedures required its employees to determine that each bond swap was suitable prior to recommending the transaction to the customer, there was no evidence that such determination was made or reviewed with respect to any of these swaps. As a result, MSSB willfully violated MSRB Rules G-8, G-17, G-19, and G-27 and Section 15(B)(c)(1) of the Exchange Act.

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 is registered with the Commission as both a broker dealer and an investment adviser, and with the MSRB as a broker dealer.

Facts

3. Municipal bonds are fixed income securities issued by cities, counties, states, and other governmental entities to finance projects that are considered beneficial to the public good, such as the construction of schools, highways, hospitals, and sewer systems. Municipal bonds are available in a range of maturities, credit qualities, and structures and can be used to address a number of investment objectives.

4. MSSB advised investors that MSSB had dedicated municipal bond specialists who used their industry expertise to engage in comprehensive and thoughtful analysis prior to recommending that a customer engage in a particular strategy or municipal bond transaction. One type of transaction that MSSB recommended to its customers was municipal bond swaps. In such a transaction, a customer both buys and sells a municipal bond, thereby “swapping” one security for another. Most of the swap transactions at issue in this Order involved purchases and sales on the same day.

5. In accordance with MSRB rules, MSSB’s policies and procedures require its employees to proactively determine that a particular investment or investment strategy is suitable for a customer prior to recommending the investment or strategy to the customer. Thus, MSSB’s

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.

employees are prohibited from recommending that a customer engage in a swap transaction where MSSB's employees have not determined that the transaction is intended to benefit the customer.

6. Prior to May 2017, MSSB had no specific policies relating to the review of its fixed income swap transactions. In approximately May 2017, MSSB implemented a new procedure that was designed to identify patterns of swap transactions that MSSB viewed as being inherently questionable and which warranted supervisory review.

7. During the period from June 28, 2013 through December 19, 2017, MSSB recommended 135 municipal bond swap transactions to its retail customers that, based on the bonds' features, provided no apparent economic benefit to the customers.

8. In 69 instances, MSSB recommended and executed swap transactions where the municipal bonds being bought and sold were nearly identical. The municipal bonds involved in each of these transactions involved the same issuer and most, if not all, of the same features. In particular, the taxability, maturity, callability, and stated coupon of the purchased bonds were all either inferior or substantially similar to those of the bonds sold. Moreover, the yield on the bonds purchased was, in most instances, lower than the yield on the bonds sold. In those instances in which the yield was not lower, it was either the same or only slightly higher – meaning that the costs incurred to effectuate the transactions negated any pick up in yield. As a result, based on the bonds' features, it does not appear that MSSB had a reasonable basis to believe that the recommended swaps were suitable. MSSB received commissions and fees totaling \$178,621.63 in connection with these 69 transactions.

9. In 66 instances, MSSB recommended and executed swap transactions where the issuers were different, but the bonds being bought and sold shared features. In each of these transactions, the bond being purchased had a yield that was less than the bond being sold, the bond being purchased did not have a better credit rating than the bond being sold, and the time to maturity of the bond being purchased was not significantly shorter than that of the bond being sold. Thus, the swaps resulted in the customer receiving a lower resulting yield without receiving any corresponding benefit, such as better credit quality or a significantly shorter time to redemption. As a result, based on the bonds' features, it does not appear that MSSB had a reasonable basis to believe that the recommended swaps were suitable. MSSB received commissions and fees totaling \$163,520.32 in connection with these 66 transactions.

10. At the time the transactions were recommended or executed, MSSB did not document information about its customers that indicated that any of the 135 swaps were suitable for these particular customers.

11. MSSB received commissions and fees upon the execution of these 135 swap transactions totaling \$342,141.95.

12. MSSB has paid remuneration to customers in the amount of \$394,556.85, which includes interest accrued since the relevant transaction dates.

Violations

13. Section 15B(b) of the Exchange Act established the MSRB and empowered it to propose and adopt rules for transactions in municipal securities by broker dealers. Section 15B(c)(1) of the Exchange Act prohibits a broker dealer from using the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security in contravention of any rule of the MSRB. As a broker dealer, MSSB is subject to Section 15B(c)(1) of the Exchange Act and the MSRB Rules.

14. MSRB Rule G-17 requires broker dealers to deal fairly with all persons and not to engage in any deceptive, dishonest, or unfair practice. Rule G-17 does not merely prohibit deceptive conduct. It also establishes a general duty to deal fairly with all persons. Even where other MSRB rules provide for specific disclosures or other actions by, or establish specific standards of behavior for, broker dealers, such disclosures, actions, or behavior must also comport with the fair practice principles of Rule G-17.

15. MSRB Rule G-19 provides that, in recommending a municipal securities transaction, a broker dealer shall have reasonable grounds for believing that the recommendation is suitable, based upon information about the security that is available from the issuer of the security or otherwise, and based upon the facts disclosed by or otherwise known about the customer. The obligation arising under Rule G-19 in connection with a recommended transaction requires a meaningful analysis, taking into consideration the information obtained about the investor and the security, which establishes the reasonable grounds for believing the recommendation is suitable. Such suitability determinations are required regardless of the apparent safety of a particular security or issuer or the apparent wealth or sophistication of a particular investor.

16. MSRB Rule G-8 requires broker dealers to maintain information about their customers obtained pursuant to Rule G-19. This requires that broker dealers maintain records for each customer of the information about the customer that was used in making recommendations to the customer.

17. MSRB Rule G-27(a) requires broker dealers to supervise their municipal securities activities, including the activities of their associated persons to ensure compliance with the MSRB rules, as well as the applicable provisions of the Exchange Act and the rules thereunder. Additionally, MSRB Rule G-27(c) requires each broker dealer to “adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance as required in section (a) of this rule.”

18. Pursuant to MSRB Rule G-27, a broker dealer must have written supervisory procedures in place that are reasonably designed to ensure compliance with the Rule G-19 obligation to undertake a suitability analysis in connection with every recommended transaction, and broker dealers must enforce these procedures to ensure that such a meaningful analysis does in fact occur in connection with the recommended transactions.

19. As a result of the conduct described above, MSSB willfully² violated Section 15B(c)(1) of the Exchange Act and MSRB Rules G-8, G-17, G-19, and G-27.

IV.

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

Accordingly, pursuant to Sections 15(b), 15B(c), and 21C of the Exchange Act and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. MSSB cease and desist from committing or causing any violations and any future violations of Section 15B(c)(1) of the Exchange Act and MSRB Rules G-8, G-17, G-19, and G-27.

B. MSSB is censured.

C. MSSB shall, within ten (10) days of the issuance of this Order, pay a civil money penalty to the Securities and Exchange Commission in the amount of \$225,000.00, of which \$112,500.00 shall be transferred to the Municipal Securities Rulemaking Board in accordance with Section 15B(c)(9)(A) of the Exchange Act, and of which the remaining \$112,500.00 shall be transferred to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

D. 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:

² "Willfully," for purposes of imposing relief under Section 15(b) of the Exchange Act and Section 203(e) of the Advisers Act, "means no more than 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." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

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 Lara Shalov Mehraban, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, New York 10281.

E. 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.

Vanessa A. Countryman
Secretary