

**UNITED STATES OF AMERICA**  
**Before the**  
**COMMODITY FUTURES TRADING COMMISSION**

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10:44 am, Aug 06, 2015

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In the Matter of: )

MORGAN STANLEY & CO. LLC, )

Respondent. )

CFTC Docket No. 15-26

**ORDER INSTITUTING PROCEEDINGS PURSUANT TO  
SECTIONS 6(c) AND 6(d) OF THE COMMODITY EXCHANGE ACT, MAKING  
FINDINGS AND IMPOSING REMEDIAL SANCTIONS**

**I.**

The Commodity Futures Trading Commission (“Commission”) has reason to believe that Morgan Stanley & Co. LLC (“Morgan Stanley” or “Respondent”) violated Commission Regulations 22.9 and 166.3. Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Respondent engaged in the violations set forth herein and to determine whether any order should be issued imposing remedial sanctions.

**II.**

In anticipation of the institution of an administrative proceeding, Respondent has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondent consents to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions (“Order”) and acknowledges service of this Order.<sup>1</sup>

<sup>1</sup> Respondent consents to the entry of this Order and to the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party; provided, however, that Respondent does not consent to the use of the Offer, or the findings or conclusions in this Order consented to in the Offer, as the sole basis for any other proceeding brought by the Commission, other than in a proceeding in bankruptcy or to enforce the terms of this Order. Nor does Respondent consent to the use of the Offer or this Order, or the findings or conclusions in this Order consented to in the Offer, by any other party in any other proceeding.

### III.

The Commission finds the following:

#### A. SUMMARY

On numerous days from March 12, 2013 to March 7, 2014, Morgan Stanley failed to hold sufficient US Dollars in segregated accounts in the United States on behalf of cleared swaps customers to meet all US Dollar obligations to those customers, as specified in Regulations 1.49(b)(1) and (e), in violation of Regulation 22.9(a). During a longer period, from November 8, 2012 to on or about April 8, 2014, Morgan Stanley did not have in place adequate procedures to ensure that it complied with Regulation 22.9(a), in violation of Regulation 166.3.

#### B. RESPONDENT

Morgan Stanley is a financial services firm, organized under the laws of Delaware, which is registered with the Commission as an FCM, provisionally registered with the Commission as a swap dealer, and registered with the Securities and Exchange Commission as a broker-dealer. Morgan Stanley's principal office is in New York, New York. Among other things, Morgan Stanley executes and clears customer transactions in commodity futures, swaps, stocks, and options in the United States and worldwide.

#### C. FACTS

From March 12, 2013 to March 7, 2014, on numerous days, Morgan Stanley failed to hold sufficient US Dollars in segregated accounts in the United States to meet all of its US Dollar obligations to cleared swaps customers. On those dates, Morgan Stanley held the amount of the US Dollar deficits in Euros and other currencies, rather than in US Dollars, when its cleared swaps customers did not deposit such funds in or request conversion to those currencies, and when funds did not accrue to the customers in those currencies as a result of cleared swaps carried through Morgan Stanley, to the extent of such accruals. The size of Morgan Stanley's US Dollar deficits ranged from approximately \$5 million to approximately \$265 million, at times representing more than ten percent of the amount that the firm was obligated to maintain in US Dollars for cleared swaps customers. Because Morgan Stanley held the amount of the US Dollar deficits in Euros and other currencies, it did not have a shortfall in overall cleared swaps customer collateral. Nonetheless, on the days at issue, Morgan Stanley did not maintain sufficient US Dollars in segregation to meet its US Dollar obligations to cleared swaps customers, in violation of Regulation 22.9(a).

From November 8, 2012 to on or about April 8, 2014, Morgan Stanley did not have in place adequate procedures to comply with the currency denomination requirements for holding cleared swaps customer collateral as required by Regulation 22.9(a), and Morgan Stanley did not train and supervise its personnel to ensure compliance with Regulation 22.9(a). On or about April 8, 2014, Morgan Stanley learned of its failure to comply with Regulation 22.9(a) from a routine financial examination conducted by the Financial and Regulatory Surveillance Department of the Chicago Mercantile Exchange ("CME"). Morgan Stanley promptly investigated the deficiencies and implemented procedures to ensure that it would maintain sufficient US Dollars to satisfy its requirements for holding cleared swaps customer collateral.

Morgan Stanley also promptly reported the deficiencies to the Commission and cooperated with the Division of Enforcement in its investigation relating to this proceeding.

#### IV.

### LEGAL DISCUSSION

#### A. Failure to Maintain Sufficient US Dollars for Cleared Swaps Obligations

In relevant part, Regulation 22.9(a) provides, subject to Regulation 22.9(b), that FCMs “may hold Cleared Swaps Customer Collateral in the denominations, at the locations and depositories, and subject to the segregation requirements specified in [Regulation 1.49].” 17 C.F.R. § 22.9(a).<sup>2</sup>

Regulation 1.49(b)(1) provides that “a [FCM’s] obligations to a customer shall be denominated: (i) [i]n the United States dollar; (ii) [i]n a currency in which funds were deposited by the customer or were converted at the request of the customer, to the extent of such deposits and conversions; or (iii) [i]n a currency in which funds have accrued to the customer as a result of trading conducted on a designated contract market, to the extent of such accruals.” *See also* Regulation 22.9(b) (providing that “a [FCM’s] obligations to a Cleared Swaps Customer may be denominated in a currency in which funds have accrued to the Cleared Swaps Customer as a result of a Cleared Swap carried through such [FCM], to the extent of such accruals”).

Additionally, Regulation 1.49(e) provides that an FCM “must, as of the close of each business day, hold in segregated accounts . . . [s]ufficient United States dollars, held in the United States, to meet all United States dollar obligations.” 17 C.F.R. § 1.49(e)(1)(i).

Morgan Stanley’s US Dollar deficits on the numerous days at issue represented US Dollar obligations to the firm’s cleared swaps customers that were improperly maintained in non-US Dollar currencies. As of the close of business on each of those days, Morgan Stanley did not hold sufficient US Dollars in segregated accounts in the United States to meet all of its US Dollar obligations to its cleared swaps customers. By holding portions of its US Dollar obligations in other currencies, Morgan Stanley failed to comply with these requirements of Regulation 1.49. *See In the Matter of Interactive Brokers LLC*, CFTC Docket No. 13-19 (Apr. 9, 2013) (finding that FCM violated Regulation 1.49(b) and (e) by holding portions of its US Dollar obligations to futures customer in other currencies, even when the firm had sufficient excess segregated funds overall). Respondent thereby violated Regulation 22.9(a), 17 C.F.R. § 22.9(a).

#### B. Failure to Diligently Supervise

Commission Regulation 166.3, 17 C.F.R. § 166.3, requires that –

Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or

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<sup>2</sup> Regulation 22.9 became effective April 9, 2012, and all parties were required to comply by November 8, 2012. *See* Protection of Cleared Swaps Customer Contracts and Collateral, 77 Fed. Reg. 6,336 (Feb. 7, 2012) (codified at 17 C.F.R. pt. 22).

performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

A violation under Regulation 166.3 is an independent violation for which no underlying violation is necessary. *See In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,744 (CFTC Dec. 10, 1997).

A violation of Regulation 166.3 is demonstrated by showing either that (1) the registrant's supervisory system was generally inadequate; or (2) the registrant failed to perform its supervisory duties diligently. *In re Murlas Commodities*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,485 at 43,161 (CFTC Sept. 1, 1995); *In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,219 (CFTC Aug. 11, 1992) (providing that, even if an adequate supervisory system is in place, Regulation 166.3 can still be violated if the supervisory system is not diligently administered), *aff'd sub nom. Monieson v. CFTC*, 996 F.2d 852 (7th Cir. 1993); *In re Paragon Futures Ass'n*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266 at 38,850 (CFTC Apr. 1, 1992) ("The focus of any proceeding to determine whether Rule 166.3 has been violated will be on whether [a] review [has] occurred and, if it did, whether it was diligent."); *Samson Refining Co. v. Drexel Burnham Lambert, Inc.* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,596 at 36,566 (CFTC Feb. 16 1990) (noting that, under Regulation 166.3, an FCM has a "duty to develop procedures for the detection and deterrence of possible wrongdoing by its agents") (internal quotation omitted). Evidence of violations that "should be detected by a diligent system of supervision, either because of the nature of the violations or because the violations have occurred repeatedly," is probative of a failure to supervise. *In re Paragon Futures*, ¶ 25,266 at 38,850. *See In the Matter of Interactive Brokers LLC*, CFTC Docket No. 13-19 (Apr. 9, 2013) (finding that firm violated Regulation 166.3 by failing to have procedures in place to ensure compliance with, among other provisions, the currency denomination requirements for customer protection under Regulation 1.49).

Throughout the period from November 8, 2012 (the compliance date for the cleared swaps customer collateral rules) to at least April 8, 2014 (when the violations of Regulation 22.9(a) were discovered), Morgan Stanley did not have procedures in place to ensure compliance with Regulation 22.9(a), 17 C.F.R. § 22.9(a), and the firm did not train and supervise its personnel to ensure compliance with this rule. Morgan Stanley thereby failed to supervise diligently its officers, employees, and agents and did not have sufficient procedures in place to detect and deter the violations of the Regulations found herein, in violation of Regulation 166.3, 17 C.F.R. § 166.3.

**V.**

**FINDINGS OF VIOLATIONS**

Based on the foregoing, the Commission finds that Morgan Stanley violated Regulations 22.9(a) and 166.3, 17 C.F.R. §§ 22.9(a) and 166.3.

**VI.**

**OFFER OF SETTLEMENT**

Respondent has submitted the Offer in which it, without admitting or denying the findings and conclusions herein:

- A. Acknowledges receipt of service of this Order;
- B. Admits the jurisdiction of the Commission with respect to all matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based on violation of or enforcement of this Order;
- C. Waives:
  - 1. The filing and service of a complaint and notice of hearing;
  - 2. A hearing;
  - 3. All post-hearing procedures;
  - 4. Judicial review by any court;
  - 5. Any and all objections to the participation by any member of the Commission's staff in the Commission's consideration of the Offer;
  - 6. Any and all claims that it may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2012) and 28 U.S.C. § 2412 (2012), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Regulations, 17 C.F.R. §§ 148.1-30 (2014), relating to, or arising from, this proceeding;
  - 7. Any and all claims that it may possess under the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, §§ 201-253, 110 Stat. 847, 857-868 (1996), as amended by Pub. L. No. 110-28, § 8302, 121 Stat. 112, 204-205 (2007), relating to, or arising from, this proceeding; and
  - 8. Any claims of Double Jeopardy based on the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief;
- D. Stipulates that the record basis on which this Order is entered shall consist solely of the findings contained in this Order to which Respondent has consented in the Offer;

- E. Consents, solely on the basis of the Offer, to the Commission's entry of this Order that:
1. Makes findings by the Commission that Respondent violated Regulations 22.9(a) and 166.3, 17 C.F.R. §§ 22.9(a) and 166.3;
  2. Orders Respondent to cease and desist from violating Regulations 22.9(a) and 166.3, 17 C.F.R. §§ 22.9(a) and 166.3;
  3. Orders Respondent to pay a civil monetary penalty in the amount of three-hundred thousand dollars (\$300,000) within ten (10) days of the date of entry of this Order;
  4. Orders Respondent to comply with its undertakings consented to in the Offer and as set forth in Part VII of this Order.

Upon consideration, the Commission has determined to accept the Offer.

## VII.

### ORDER

**Accordingly, IT IS HEREBY ORDERED THAT:**

- A. Respondent and its successors and assigns shall cease and desist from violating Regulations 22.9(a) and 166.3, 17 C.F.R. §§ 22.9(a) and 166.3.
- B. Respondent shall pay a civil monetary penalty in the amount of three-hundred thousand dollars (\$300,000) ("CMP Obligation") within ten (10) days of the date of entry of this Order. If the CMP Obligation is not paid in full within ten (10) days of the date of entry of this Order, then post-judgment interest shall accrue on the CMP Obligation beginning on the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of this Order pursuant to 28 U.S.C. § 1961 (2012).

Respondent shall pay the CMP Obligation by electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made other than by electronic funds transfer, then the payment shall be made payable to the Commodity Futures Trading Commission and sent to the address below:

Commodity Futures Trading Commission  
Division of Enforcement  
ATTN: Accounts Receivables --- AMZ 340  
E-mail Box: 9-AMC-AMZ-AR-CFTC  
DOT/FAA/MMAC  
6500 S. MacArthur Blvd.  
Oklahoma City, OK 73169  
Telephone: (405) 954-7262

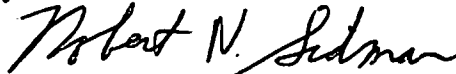
If payment is to be made by electronic funds transfer, Respondent shall contact Nikki Gibson or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondent shall accompany payment of the CMP

Obligation with a cover letter that identifies the paying Respondent and the name and docket number of this proceeding. The paying Respondent shall simultaneously transmit copies of the cover letter and the form of payment to the Chief Financial Officer, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581, and to Manal M. Sultan, Deputy Director, Division of Enforcement, Commodity Futures Trading Commission, 140 Broadway, 19<sup>th</sup> Floor, New York, NY 10005.

- C. Respondent and its successors and assigns shall comply with the following undertakings set forth in the Offer:
1. **Public Statements**: Respondent agrees that neither it nor any of its successors or assigns, agents, or employees under its authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in this Order or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision shall affect Respondent's (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Respondent and its successors and assigns shall undertake all steps necessary to ensure that all of its agents and/or employees under its authority or control understand and comply with this agreement.
  2. **Cooperation with the Commission**: Respondent shall continue to cooperate fully and expeditiously with the Commission, including the Commission's Division of Enforcement, in this proceeding and in any civil or criminal investigation, litigation, or administrative or self-regulatory matter related to the subject matter of this proceeding.
  3. **Partial Satisfaction**: Respondent understands and agrees that any acceptance by the Commission of any partial payment of Respondent's CMP Obligation shall not be deemed a waiver of its obligation to make further payments pursuant to this Order, or a waiver of the Commission's right to seek to compel payment of any remaining balance.

**The provisions of this Order shall be effective as of this date.**

By the Commission.



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Robert N. Sidman  
Deputy Secretary of the Commission  
Commodity Futures Trading Commission

Dated: August 6, 2015