



UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of:

Morgan Stanley Smith Barney, LLC,

Respondent.

CFTC Docket No. 14-25

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 Smith Barney, LLC (“MSSB”), a registered futures commission merchant (“FCM”), has violated Section 4g(a) of the Commodity Exchange Act (“Act”), 7 U.S.C. § 6g(a) (2012), and Commission Regulations (“Regulation”) 1.31(a), 1.35(a), and 166.3, 17 C.F.R. §§ 1.31(a), 1.35(a), and 166.3 (2013). The Commission, therefore, deems it appropriate and in the public interest that a public administrative proceeding be, and hereby is, instituted to determine whether MSSB 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, MSSB has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings and conclusions herein, MSSB acknowledges service 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”).¹

¹ MSSB consents to the entry of this Order, 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 MSSB does not consent to the use of the Offer, or the findings in this Order consented to in the Offer, as the sole basis for any other proceeding brought by the Commission, other than a proceeding in bankruptcy or to enforce the terms of this Order. In addition, MSSB does not consent to the use of the Offer or this Order, or the findings consented to in the Offer or this Order, by any other party in any other proceeding.

III.

The Commission finds the following:

A. Summary

Between April and November 2010, MSSB failed to diligently supervise its officers', employees', and agents' opening and handling of accounts held at MSSB in the name of a family of companies called SureInvestment, in violation of Regulation 166.3, 17 C.F.R. § 166.3. In particular, MSSB's officers, employees, and agents failed to diligently supervise by failing to sufficiently "know its customer" prior to opening accounts, which it was later revealed were used by the owner of SureInvestment, Benjamin Wilson ("Wilson"),² in a multimillion dollar Ponzi scheme (the "SureInvestment scheme"), and by failing to adequately monitor and enforce trading limits applicable to those accounts. During the relevant period, the SureInvestment accounts generated \$16,351.86 for MSSB in gross commissions and fees.

Further, MSSB failed to respond timely and accurately to a Division of Enforcement ("Division") request for production of account records. In addition, MSSB failed to maintain adequate records regarding the daily trading limit applicable to one of the SureInvestment accounts. Together these incidents constitute violations of Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31(a) and 1.35(a), 17 C.F.R. §§ 1.31 & 1.35 (2013).

B. Respondent

Morgan Stanley Smith Barney, LLC is a New York limited liability company originally formed as a joint venture between Morgan Stanley & Co. and Citigroup Inc., with its principal place of business in Purchase, New York. MSSB has been registered with the Commission as an FCM since May 18, 2009.

C. Facts

1. **MSSB Failed to Supervise Diligently the Opening and Handling of the SureInvestment Accounts by Its Officers, Employees, and Agents**
 - a. **MSSB ignored or failed to sufficiently investigate multiple warning signs of suspicious activity**

The process of opening the SureInvestment accounts at MSSB began in April 2010. Based on SureInvestment's representations, MSSB understood that SureInvestment planned to initially fund the account with \$100 million. Neither Wilson nor any of the SureInvestment entities previously held an account at MSSB, and two of the entities were located in the British Virgin Islands ("B.V.I."), deemed a "high risk jurisdiction" under MSSB's compliance procedures. Therefore, the opening of these accounts was subject to special scrutiny pursuant to MSSB's Enhanced Due Diligence ("EDD") and Customer Identification Program ("CIP") procedures.

² In 2013, Wilson (a United Kingdom citizen) pled guilty to criminal charges brought by the U.K. Financial Conduct Authority arising from Wilson's operation of SureInvestment, a \$35 million Ponzi scheme. In February of this year, Wilson was sentenced to seven years imprisonment.

Pursuant to the EDD and CIP process, specific types of documents were required from SureInvestment in order for MSSB to open the accounts. One of the documents produced by SureInvestment was a 2008 audit of a separate SureInvestment entity domiciled in the B.V.I. Though this entity was not seeking to open an account, MSSB incorporated the audit into its account verification process for the other SureInvestment entities.

The 2008 audit received by MSSB on its face contained several suspicious irregularities. For instance, the audit contained numerous typos throughout the document. SureInvestment also produced similar audits from 2006 and 2007 which contained the same typos as the 2008 version. A 2009 audit was never produced even though other materials provided by SureInvestment to MSSB reflected operations by the audited entity through at least November 2009. A simple internet search would have revealed that neither the SureInvestment entity that was the subject of the audits nor the purported B.V.I. auditing firm and its principals actually existed.

In addition to the audits, Wilson provided MSSB with prospectuses and similar documents regarding the non-existent SureInvestment entity claiming a compounded average return on investment from 2003 to 2009 of 2,850%, with profits earned in 72 of 76 months of trading including a string of 45 consecutive profitable months.

The EDD and CIP processes set forth in MSSB's compliance manuals required MSSB personnel to "know their customer" and to be alert for any "red flags" regarding suspicious activity prior to opening an account. These compliance manuals included numerous admonitions to MSSB personnel, including the following:

- "The [Financial Advisor] and Branch Manager should ensure that sufficient information has been obtained via the EDD online responses to corroborate the client's source of wealth (SOW). It is therefore important that specific, detailed information be requested upfront [sic] from the client. Attention should be paid to the consistency of the client's responses and what is known about the client. Incomplete or inconsistent responses may present significant risk to both employees and the Firm."
- "Risk Indicators for Suspicious Activity" include a client or prospect who "claims to have or to control large sums of money and is seeking to establish a relationship with a [Financial Advisor] with whom there was little or no prior relationship" and/or "is located in a country that has been deemed by the Firm to be a High Risk Jurisdiction."
- "It is a regulatory requirement to 'know your customers' well enough to: ... have enough background information to make a reasonable assessment of the legitimacy of their source of funds."
- "Be particularly wary of exaggerated claims concerning a prospective client's business or business prospects..."
- "Clients who are located in, or who wire money to or from, [high-risk jurisdictions including the B.V.I.] should be regarded with a heightened degree of scrutiny. Be particularly wary of any other 'red flags' associated with such clients."
- "If...the client provides suspicious documentation, escalate the issue promptly to the AML Group."

- “General Internet searches and specific website searches can often yield considerable information regarding clients and related individuals or entities.”

Despite the numerous red flags presented by SureInvestment’s account opening documents, MSSB allowed all four accounts to be opened. Approximately \$1.4 million flowed through these accounts, and approximately \$600,000 of these funds was lost trading futures.

b. MSSB failed to properly enforce its own trading limit assigned to the SureInvestment accounts

At the time the SureInvestment accounts were opened, MSSB placed a trading limit³ of \$250,000 on the accounts. Only one of the accounts engaged in trading, and trading in this account began on August 12, 2010. On September 16, 2010, this account exceeded its trading limit and continued to do so until MSSB discovered the violation on November 4, 2010. The position in the account was ultimately closed on November 5, 2010 resulting in total net losses in the account of more than \$608,000, more than double the applicable trading limit.

2. MSSB Failed to Properly Respond to a Commission Document Request and to Maintain Complete Records

In September 2011 the Division issued a request to MSSB pursuant to Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31 and 1.35, 17 C.F.R §§ 1.31 and 1.35 (2013), for account records pertaining to the SureInvestment entities. The Division received a response from Morgan Stanley & Co. LLC, an affiliate of MSSB, stating that it had no record of any accounts in the names of these entities. Several weeks later, the Division discovered purported account numbers for accounts held by SureInvestment entities at MSSB. When presented with this information, MSSB responded that, in fact, it held four SureInvestment accounts that were opened in 2010, and MSSB subsequently produced the requested records. In addition, while MSSB identified the trading limit set when the SureInvestment accounts were opened, MSSB was unable to produce any record of the applicable limit over the life of the accounts, explaining that such information was not stored in any retrievable format.

D. Legal Discussion

1. MSSB Failed to Supervise Diligently Its Officers, Employees, and Agents Responsible for Opening and Monitoring the SureInvestment Accounts

Regulation 166.3, 17 C.F.R. § 166.3 (2013), requires,

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 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

³ According to MSSB’s compliance manual, “trading limit” is defined as “the amount of ‘initial margin’ requirements that an account can have open at any one time. Initial Margin is the good faith deposit that a client must deposit for each futures contract...”

persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

A violation under Regulation 166.3, 17 C.F.R. § 166.3 (2013), 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, 17 C.F.R. § 166.3 (2013), 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); *In re Paragon Futures Assoc.*, [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"). 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 Assoc.*, ¶ 25,266 at 38,850.

During the relevant periods described above, MSSB failed to perform its supervisory duties diligently by not following its compliance procedures that were in place, in violation of Regulation 166.3, 17 C.F.R. § 166.3 (2013). For example, MSSB failed to sufficiently investigate warning signs of suspicious activity, including questions raised by the suspicious audits and prospectuses. In doing so, MSSB ignored "exaggerated claims concerning a prospective client's business or business prospects" and ultimately failed to obtain "sufficient information" to confirm the legitimacy of SureInvestment's source of funds. In essence, MSSB failed to properly "know" its customer prior to opening the accounts, despite the fact that the accounts involved a client from a "high risk jurisdiction" who claimed "to control large sums of money and is seeking to establish a relationship with a [Financial Advisor] with whom there was little or no prior relationship."

MSSB also violated Regulation 166.3, 17 C.F.R. § 166.3 (2013), by failing to properly monitor the trading activity in one of the SureInvestment accounts and allowing the subject account to exceed its trading limit for seven weeks before closing out the position at a loss greater than what the loss likely would have been had the trading limit been properly monitored and enforced.

2. MSSB Failed to Properly Respond to a Commission Document Request and to Maintain Complete Records of Its Transactions Relating to Its Business of Dealing in Commodity Futures

Regulation 1.35, 17 C.F.R. § 1.35 (2013), requires an FCM to keep "full, complete, and systematic records, together with all pertinent data and memoranda, of all transactions relating to its business of dealing in commodity futures." Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), requires FCMs, among other registrants, to maintain these records "in such form and manner and for such period as may be required by the Commission" and to "keep such books and records open to inspection by any representative of the Commission." The Regulations further elaborate that FCMs, among other registrants, must promptly provide required books and records and "furnish

true and correct information and reports as to the contents or the meaning thereof² to a Commission representative upon the representative's request. Regulations 1.31 and 1.35, 17 C.F.R. §§ 1.31 and 1.35 (2013); *see also In re Forex Capital Markets LLC*, No. 12-01 (CFTC Oct. 3, 2011) (holding that FCM violated Section 4g of the Act and Regulation 1.35 by failing to produce promptly certain records sought in 4g requests). A violation of these record-keeping regulations does not require scienter. *In re GNP Commodities*, Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,214 (Aug. 11, 1992); *see also In re Buckwalter*, Comm. Fut. L. Rep. (CCH) ¶24,995 at 37,687 (Jan. 25, 1991); *In re DiPlacido*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. ¶ 29,866 at 56,590 (CFTC Sept. 14, 2004).

MSSB violated Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2102), and Regulations 1.31(a) and 1.35(a), 17 C.F.R. §§ 1.31(a) and 1.35(a) (2013), because it did not respond accurately and timely to the Division's 4g request and failed to maintain daily records of the trading limit applicable to the SureInvestment accounts. Only after being informed by Division staff of the actual MSSB account numbers for the SureInvestment accounts (discovered in a third party's records) did MSSB comply with the Division's 4g request.

IV.

FINDINGS OF VIOLATIONS

Based on the foregoing, the Commission finds that MSSB violated Section 4g(a) of Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31(a), 1.35(a), and 166.3, 17 C.F.R. §§ 1.31(a), 1.35(a), and 166.3 (2013).

V.

OFFER OF SETTLEMENT

MSSB has submitted the Offer in which it, without admitting or denying the findings 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;
- C. Waives: the filing and service of a complaint and notice of hearing; a hearing; all post-hearing procedures; judicial review by any court; any and all objections to the participation by any member of the Commission's staff in the Commission's consideration of the Offer; 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 Part 148 of the Regulations, 17 C.F.R. §§ 148.1, *et seq.* (2013), relating to, or arising from, this proceeding; 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 any claim of Double Jeopardy based upon 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 upon which this Order is entered shall consist solely of the findings contained in this Order, to which MSSB has consented; and
- E. Consents, solely on the basis of the Offer, to entry of this Order that:
1. Makes findings by the Commission that MSSB violated Regulation 166.3, 17 C.F.R. § 166.3 (2013);
 2. Makes findings by the Commission that MSSB violated Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31(a) and 1.35(a), 17 C.F.R. §§ 1.31(a) and 1.35(a) (2013);
 3. Orders MSSB to cease and desist from violating Regulation 166.3, 17 C.F.R. § 166.3 (2013);
 4. Orders MSSB to cease and desist from violating Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31(a) and 1.35(a), 17 C.F.R. §§ 1.31(a) and 1.35(a) (2013);
 5. Orders MSSB to pay a civil monetary penalty of \$280,000 within ten days of the entry of this Order; and
 6. Orders MSSB and its successors and assigns to comply with the undertakings consented to in the Offer and set forth below in Part VI of this Order.

Upon consideration, the Commission has determined to accept MSSB's Offer.

VI.

Accordingly, IT IS HEREBY ORDERED THAT:

- A. MSSB shall cease and desist from violating Regulation 166.3, 17 C.F.R. § 166.3 (2013);
- B. MSSB shall cease and desist from violating Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31(a) and 1.35(a), 17 C.F.R. §§ 1.31(a) and 1.35(a) (2013);
- C. MSSB shall pay a civil monetary penalty of \$280,000 within ten days of the entry of this Order. Should MSSB not satisfy its civil monetary penalty within ten days of the date of entry of this Order, post-judgment interest shall accrue on its civil monetary penalty 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). MSSB shall pay this civil monetary penalty by making an electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made by other than an electronic funds transfer, 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
DOT/FAA/MMAC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
Telephone (405) 954-5644

If payment by electronic transfer is chosen, MSSB shall contact Nikki Gibson or her successor at the above address to receive payment instructions and shall fully comply with those instructions. MSSB shall accompany payment of the penalty with a cover letter that identifies MSSB, and the name and docket number of this proceeding. MSSB shall simultaneously transmit copies of the cover letter and the form of payment to: (1) the Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 20581; (2) the Chief, Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission at the same address; and (3) Daniel Jordan, Chief Trial Attorney, Division of Enforcement, Commodity Futures Trading Commission at the same address; and

D. MSSB and its successors and assigns shall comply with the following conditions and undertakings set forth in the Offer:

1. Disgorgement

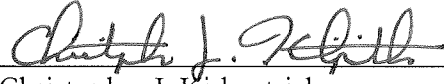
MSSB shall pay disgorgement in the amount of \$16,351.86 within ten (10) days of the date of the entry of the Order. Should MSSB not satisfy its disgorgement obligation within ten days of the date of entry of this Order, post-judgment interest shall accrue on its disgorgement obligation beginning on 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). MSSB shall pay its disgorgement obligation in the same manner as required for payment of its civil monetary penalty described above.

2. Actions or Public Statements

MSSB agrees that neither it nor any of its 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 the Order, or creating, or tending to create, the impression that the Order is without a factual basis; provided, however, that nothing in this provision shall affect MSSB's: (1) testimonial obligations; or (2) right to take legal positions in other proceedings to which the Commission is not a party. MSSB shall undertake all steps necessary to ensure that all of its agents and employees under its authority and/or control understand and comply with this agreement.

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

By the Commission.



Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: September 15, 2014