

III.

The Commission finds the following:

A. Summary

Respondent's "Customer A" provided trust services for its clients, and in the course of providing such services to one of its clients, Customer A accepted orders to trade commodity futures contracts on behalf of its own third party client, accepted the third party client's money to place those trades, and effected the trades via a contract market on the third party client's behalf. These contracts were traded in a proprietary futures account in Customer A's name carried initially at the registered futures commission merchant ("FCM") Citigroup Global Markets Inc. ("CGMI") and later in an account carried by Respondent. Respondent was created as a joint venture including assets contributed by CGMI in 2009. By accepting the orders to purchase a commodity for future delivery on behalf of the third party client subject to the rules of a contract market, and accepting the third party client's money to secure those trades, Customer A acted as an FCM without being registered as such, in violation of the Act.

From 2006 to 2008, Customer A conducted five transfers of funds from its proprietary commodity futures trading account. These transactions clearly showed funds moving from Customer A's proprietary futures trading account to a third party client's bank account. The fact that funds were moving from a proprietary trading account to a third party bank account should have led Respondent's employees executing the transactions to question Customer A's actions and to investigate to determine whether the account was being carried properly. However, Respondent's employees failed to diligently investigate the suspicious transactions.

No later than January 15, 2010, Respondent realized that the Customer A's proprietary futures trading account had been carried improperly since 2006. Respondent's New York office began issuing emails to Respondent's Oklahoma branch on January 15, 2010, indicating that Customer A's account would have to be closed and a new account in the underlying third party client's name opened. Nonetheless, Respondent's Oklahoma branch continued to allow trading on behalf of the third party client to take place in Customer A's account in January 2010, March 2010, and May 2010. The third party client's funds were ultimately moved from Customer A's proprietary account to an account in the third party client's name on or about May 27, 2010.

At the time of the above-described events, Respondent maintained an inadequate system of supervision and internal controls to detect and deter violations of the Act and Regulations including: (1) an unregistered FCM trading through a proprietary account carried by Respondent; and (2) not carrying an account in the true name of the client. Consequently, Respondent failed to diligently supervise the handling by its partners, officers, employees and agents (or persons

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 consented to in the Offer or this Order, by any other party in any other proceeding.

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 persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant in violation of Regulation 166.3, 17 C.F.R. §166.3 (2012).

B. Respondent

Morgan Stanley Smith Barney LLC – Morgan Stanley Smith Barney LLC is a registered FCM. Morgan Stanley Smith Barney LLC is a joint venture whose assets include those contributed by CGMI. Its registered office address is 2000 Westchester Avenue, Purchase, NY 10577.

C. Facts

1. Respondent's Employees Allowed Customer A to Use a Proprietary Account to Act as an Unregistered FCM.

From 2006 to May 2010, Customer A used its futures trading account to trade futures contracts for a third party client. The account opening documents for this account clearly show that the account is a proprietary account and specifically state that there will be no third party deposits, withdrawals, or wire transfers. Nonetheless, Customer A accepted orders from a third party client and placed the third party client's money into Customer A's proprietary futures trading account. It then placed trades on the third party client's behalf without registering with the Commission, thereby acting as an unregistered FCM.

On five occasions, between 2006 and 2008, Customer A transferred money from its proprietary trading account to a bank account in its name with instructions to transfer the money to the third party client's account. These instructions were plainly written on the transfer orders. In fact, they generally directed Respondent or CGMI to transfer the money to Customer A's own bank account "for further credit" or "FC" to the third party client. One of the transfer orders even indicated that CGMI spoke with Customer A about the transfers. Nonetheless, despite the fact that the wiring instructions plainly showed that Customer A wired money from its proprietary futures trading account to a third party's bank account, CGMI and Respondent employees failed to note that Customer A was acting as an unregistered FCM, and that the account was not carried in the true name of the actual person for whom the account was carried.

2. Respondent's Employees Allowed Customer A to Continue to Trade After Realizing The Account Was Carried Improperly and Informing Customer A it Must Set Up A New Account.

By January 15, 2010, Respondent's employees e-mailed Customer A regarding their concerns with Customer A's use of its proprietary futures trading account to trade third party funds and the manner in which the account was being carried. The e-mail indicated that the account was being carried in the name of Customer A but should be carried in the name of

Customer A's third party client. It discussed closing the then existing cattle positions and re-opening them in the third party's account. Despite the Respondent's employees written recognition of the fact that Customer A's account was improperly carried, they allowed Customer A to continue to trade in the account. Customer A proceeded to trade in January 2010, March 2010, and May 2010. This last trade took place approximately four months after Respondent knew it was carrying the account improperly.

IV.

LEGAL DISCUSSION

A. Respondent Violated Regulation 166.3

Regulation 166.3 requires that every Commission registrant (except associated persons who have no supervisory duties) diligently supervise the handling by its partners, employees and agents of all its commodity interest accounts and activities relating to its business as a registrant. Regulation 166.3 imposes on registrants an affirmative duty to supervise their employees and agents diligently by establishing, implementing, and executing an adequate supervisory structure and compliance programs. "The duty to supervise ... include[s] the broader goals of detection and deterrence of possible wrongdoing by a [registrant's] agents." *Lobb v. J.T. McKerr & Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,568 at 33,444 (CFTC Dec. 14, 1989).

In order to prove a violation of Regulation 166.3, it must be demonstrated that either: (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 Paragon Futures Assoc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266 at 38,850 (CFTC Apr. 1, 1992); *Bunch v. First Commodity Corp. of Boston*, [1990-1992 Transfer binder] Comm. Fut. L. Rep. (CCH) ¶ 25,352 at 39,168-69 (CFTC Aug. 5, 1992); *In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,219 (CFTC Aug. 11, 1992) *aff'd sub nom. Monieson v. CFTC*, 996 F 2d 852 (7th Cir. 1993); 43 Fed. Reg. 31,886, 31,889 (July 24, 1978). This is a fact intensive undertaking. *In re GNP Commodities*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,219 ("a proper determination of a FCM's supervisory diligence must remain sensitive to the particular facts and circumstances that influenced the design and execution of the system at issue"). A violation under Regulation 166.3 is an independent violation for which no underlying violation is necessary. *In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,744 (CFTC Dec. 10, 1997).

Under Regulation 166.3, a registrant has a "duty to develop procedures for the detection and deterrence of possible wrongdoing by its agents." *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) (quoting *Lobb v. J.T. McKerr & Co.*, ¶ 24,568 at 36,444). "A showing

that the registrant lacks an adequate supervisory system can be sufficient” to establish a breach of duty under Regulation 166.3. *In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,744, citing *In re First National Trading Corp.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,142 at 41,786 (CFTC July 20, 1994), *aff’d without op. sub nom. Pick v. CFTC*, 99 F.3d 1139 (6th Cir. 1996). The lack of an adequate supervisory system can be established by showing that the registrant failed to develop proper procedures for the detection of wrongdoing. See *CFTC v. Trinity Fin. Group, Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,179 at 45,635 (S.D. Fla. Sept. 29, 1997) (controlling person failed to establish or maintain meaningful procedures for detecting fraud by firm’s employees), *aff’d in part, vacated in part and remanded sub nom. Sidoti v. CFTC*, 178 F.3d 1132 (11th Cir. 1999).

If “customer orders reasonably raise concerns about their lawfulness under the Act, the futures professionals who accept or monitor the orders have a duty of further inquiry.” *In re U.S. Securities & Futures Corp.*, [2009-2011 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 31,494 at 63,572 (CFTC Oct. 7, 2009) (citations omitted) (finding that German commodity broker perpetrated a trade allocation fraud under the “willingly or recklessly blind eyes of the respondents”); see also *In re Piasio*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,276 at 50,689 (CFTC Sept. 29, 2000) (finding that the structure of orders put defendant on notice that the transactions were designed to achieve wash results in a manner that negated risk); *In re Three Eight Corporation*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,749 at 40445-46 (CFTC June 16, 1993) (holding that the receipt of paired orders for matching executions demanded clarification before execution).

Here, Respondent’s employees allowed an unregistered FCM (Customer A) to trade a third party’s funds through a proprietary futures trading account carried by Respondent. The fact that Customer A was trading for a third party was clearly demonstrated by the transfer of money from the proprietary trading account with instructions to transfer the funds to a third party bank account. These transfers raised concerns about their lawfulness under the Act, yet Respondent’s employees either did not notice them or simply failed to investigate them. Further, even after Respondent’s employees determined that it was carrying Customer A’s futures trading account improperly, they allowed Customer A to continue trading for approximately four months. Respondent failed to exercise its duty to diligently supervise its employees’ handling of the Customer A account. Therefore, Respondent violated Regulation 166.3, 17 C.F.R. § 166.3 (2012).

V.

FINDINGS OF VIOLATIONS

Based on the foregoing, the Commission finds that, during the Relevant Period, Morgan Stanley Smith Barney LLC violated Regulation 166.3, 17 C.F.R. § 166.3 (2012).

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 (2006) and 28 U.S.C. §2412 (2006), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1-30 (2012), 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 entity 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 Regulation 166.3, 17 C.F.R. § 166.3 (2012);
 2. orders Respondent to cease and desist from violating Regulation 166.3, 17 C.F.R. § 166.3 (2012);
 3. orders Respondent to pay a civil monetary penalty in the amount of two hundred thousand dollars (\$200,000), within thirty (30) days of the date of entry of this Order, plus post-judgment interest; and
 4. orders Respondent and its successors and assigns to comply with the conditions and 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 shall cease and desist from violating Regulation 166.3, 17 C.F.R. § 166.3 (2012).
- B. Respondent shall pay a civil monetary penalty in the amount of two hundred thousand dollars (\$200,000), within thirty (30) days of the date of the entry of this Order (the "CMP Obligation"). If the CMP Obligation is not paid in full within thirty (30) days of the date of entry of this Order, then post-judgment interest shall accrue on the CMP 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 (2006). 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 by other than 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
E-mail Box: 9-AMC-AMZ-AR-CFTC
DOT/FAA/MMAC
6500 S. MacArthur Blvd.

Oklahoma City, OK 73169
Telephone: (405) 954-5644

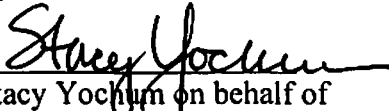
If payment by electronic funds transfer is chosen, Respondent shall contact Linda Zurhorst or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondent shall accompany payment of the CMP Obligation with a cover letter that identifies Respondent and the name and docket number of this proceeding. The 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.

- C. Respondent and its successors and assigns shall comply with the following conditions and undertakings set forth in the Offer:
1. Respondent shall review and evaluate its supervisory procedures with respect to proprietary futures trading accounts. Respondent will have in place, within thirty (30) days of the date of the Order, procedures designed to ensure that proprietary futures accounts are carried as required by the Act and to prevent customers from using these accounts to act as unregistered futures commission merchants in violation of the Act. Respondent shall provide a sworn statement signed by an officer or director of Respondent to the Division of Enforcement within 45 days of the date of entry of this Order certifying compliance with this provision and detailing the supervisory procedures required by this Order.
 2. Public Statements: Respondent agrees that neither it nor any of its successors and 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.
- D. Partial Satisfaction: Respondent understands and agrees that any acceptance by the Commission of 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.

- E. Change of Address/Phone: Until such time as Respondent satisfies in full its CMP Obligation as set forth in this Order, Respondent shall provide written notice to the Commission by certified mail of any change to his telephone number and mailing address within ten (10) calendar days of the change.

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

By the Commission


Stacy Yochum on behalf of
Sauntia S. Warfield
Assistant Secretary of the Commission
Commodity Futures Trading Commission

Dated: October 22, 2012