NYSE ARCA, INC.
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
Nos. 2015044246305 & 2017053508801

TO: NYSE Arca, Inc.
c/o Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Morgan Stanley & Co. LLC, Respondent
Broker-Dealer
CRD No. 8209

Morgan Stanley & Co. LLC violated: (i) NYSE Arca Rule 6.49-O(b), by effecting options and equity transactions after gaining knowledge of terms and conditions of client orders in the same or related options series that were not disclosed to the trading crowd ("anticipatory hedging"); and (ii) NYSE Arca Rule 11.18, by failing to establish and maintain a supervisory system reasonably designed to ensure compliance with NYSE Arca Rule 6.49-O(b). Consent to a censure, disgorgement of $2,817, and a fine of $144,983.[1]

Pursuant to Rule 10.9216 of the NYSE Arca, Inc. ("NYSE Arca" or the "Exchange") Code of Procedure, Morgan Stanley & Co. LLC ("Morgan Stanley" or the "firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, NYSE Arca will not bring any future actions against the firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. The firm hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NYSE Arca, or to which NYSE Arca is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NYSE Arca:

BACKGROUND

Morgan Stanley is a Delaware limited liability company headquartered in New York, New York. The firm, which has approximately 4,000 registered representatives in 38 branch offices, provides services to corporate and broker-dealer clients and institutional

[1] The firm consents to a total fine of $325,000 (of which $144,983 shall be paid to NYSE Arca) and total disgorgement of $40,469 (of which $2,817 shall be paid to NYSE Arca) in this and another related matter, as described in footnote 2, below. The remainder of the fine and disgorgement shall be paid to NYSE American LLC, Nasdaq Options Market, LLC, Nasdaq ISE, LLC, Nasdaq BX, Inc., Nasdaq GEMX, LLC, Cboe Exchange, Inc., Cboe C2 Exchange, Inc., BOX Exchange, LLC, Miami International Securities Exchange and MIAX PEARL, LLC.

investors, and acts as an agency broker-dealer and options market maker. The firm has been a FINRA member since June 5, 1970 and an Options Trading Permit ("OTP") Holder and member of NYSE Arca since July 29, 1974. These registrations remain in effect.

RELEVANT PRIOR DISCIPLINARY HISTORY

While the firm has no relevant disciplinary history on any of the NYSE exchanges, the firm was censured and fined $30,000 in April 2015 by the International Securities Exchange, LLC (now Nasdaq ISE, LLC) for improper anticipatory hedging (Matter No. 20130374127).

SUMMARY

1. On October 28, 2014, January 5, 2016, July 18, 2016, November 21, 2016, March 9, 2017, and April 27, 2017 (collectively, the "Trade Dates"), Morgan Stanley violated NYSE Arca Rule 6.49-O(b)[2] by effecting options and equity transactions after gaining knowledge of terms and conditions of orders in the same or related options series by its clients that were not yet disclosed to the trading crowd. From at least October 2014 through December 2018, Morgan Stanley also violated NYSE Arca Rule 11.18(b) by failing to establish and maintain supervisory systems that were reasonably designed to ensure compliance with NYSE Arca Rule 6.49-O(b).

FACTS AND VIOLATIVE CONDUCT

Violations of NYSE Arca Rule 6.49-O(b) (Anticipatory Hedging)

2. NYSE Arca Rule 6.49-O(b) provides as follows:

> It will be considered conduct inconsistent with just and equitable principles of trade for any OTP Holder or OTP Firm or person associated with a OTP [Options Trading Permit] Holder or OTP Firm, who has knowledge of all material terms and conditions of an originating order, a solicited order, or a facilitation order, the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option on the underlying securities of any option that is the subject of the order, or an order to buy or sell the security underlying any option that is the subject of the order, or any order to buy or sell any related instrument until either: (1) All the terms and conditions of the originating order and any changes in the terms or conditions of the order of which the OTP Holder or OTP Firm or

[2] Prior to August 17, 2017, the rules involved in this matter were called NYSE Arca Options rules. This document addresses two matters: (1) Matter No. 20150442463, which involves activity on October 28, 2014, January 5, 2016, July 18, 2016, November 21, 2016, and April 27, 2017 on NYSE Arca, as well as on NYSE American LLC, The Nasdaq Options Market LLC, Nasdaq ISE, LLC, Nasdaq BX, Inc., Nasdaq GEMX, LLC, Cboe Exchange Inc., and Cboe C2 Exchange, Inc.; and (2) Matter No. 20170535088, which involves activity on March 9, 2017 on NYSE Arca, as well as on NYSE American, LLC, BOX Exchange, LLC, Cboe Exchange Inc., Cboe C2 Exchange, Inc., Miami International Securities Exchange, and MIAX Pearl, LLC.

person associated with the OTP Holder or OTP Firm has knowledge are disclosed to the trading crowd, or (2) The trade can no longer reasonably be considered imminent in view of the passage of time since the order was received.

For the purposes of this rule, an order to buy or sell a "related instrument" means, in reference to an index option, an order to buy or sell securities comprising 10% or more of the component securities in the index or an order to buy or sell a futures contract on an economically equivalent index.

3. NYSE Arca Regulatory Bulletin RBO-14-02, titled "Anticipatory Hedging and Frontrunning of Floor Orders" and dated February 14, 2014, states that an OTP Holder may be deemed to have violated NYSE Arca Rule 6.49(b) if the OTP Holder, having knowledge of all material terms and conditions of an order, the execution of which is imminent, enters an order to buy or sell an option on a security underlying any option that is the subject of the order, or an order to buy or sell the security underlying any option that is the subject of the order, or any order to buy or sell any related instrument, prior to the systemization[3] and representation of such order. Since systemization must precede vocalization of an order, it establishes the best available proxy for the earliest possible time at which an order could have been disclosed to the trading crowd, at which point the order may be traded against.

4. When a member firm engages in anticipatory hedging, or otherwise uses undisclosed information about an imminent option transaction, to trade the relevant option or a related instrument, it can disadvantage market participants who are unaware of the information or who refrain from trading based on it. As set forth in NYSE Arca Rule 6.49-O(b), such conduct is considered inconsistent with just and equitable principles of trade.

5. Here, on the Trade Dates, Morgan Stanley, with knowledge of the terms and conditions of clients' orders, effected transactions for a firm account in the same or a related security, prior to disclosure to the trading crowd of the terms and conditions of the clients' orders.

6. Specifically, on October 28, 2014, a Morgan Stanley trader received a client order to buy 1,250 put options of a certain exchange-traded fund ("ABC")[4] tied to 95,000 shares of ABC stock ("Client Order 1"). During a telephone call from 10:47:22 to 10:47:55, the Morgan Stanley trader sent Client Order 1 to another broker-dealer for execution with instructions to cross the client order. At 10:48:25, after Morgan Stanley had received Client Order 1, but prior to disclosure to the trading crowd of the material terms and conditions of Client Order 1, the Morgan Stanley trader bought for a firm account 1,082 ABC put options, of which 157 executed on NYSE Arca, expecting the firm to facilitate the client order. At 10:48:30, the other broker-dealer sent the order to another exchange

[3] Systematization refers to a Floor Broker's entry of an order into an electronic format.

[4] A generic identifier has been used in place of the names of the referenced securities.

for electronic execution as a Qualified Contingent Cross ("QCC");[6] the order executed at 10:49:17.By engaging in the foregoing conduct, Morgan Stanley violated NYSE Arca Rule 6.49-O(b).

7. On January 5, 2016, a Morgan Stanley trader received a client order to sell 20,000 put options of a certain exchange-traded fund ("DEF") and buy 20,000 DEF call options ("Client Order 2"). The firm trader sliced Client Order 2 into four legs of 5,000 contracts of each series, and transmitted each leg separately to another broker-dealer, with instructions to cross. Based on Morgan Stanley's calculated net delta,[7] each of the four legs was equivalent to 290,000 DEF equity shares. After disclosure of the first leg to the trading crowd, but prior to disclosure of the second leg to the trading crowd, the Morgan Stanley trader bought 500,000 shares of DEF to facilitate Client Order 2, and thereby bought 210,000 more DEF shares than needed to hedge the disclosed portion of Client Order 2. The Morgan Stanley trader continued to over-hedge by buying more shares of DEF equity than needed to hedge the disclosed portions of the order. By improperly pre-hedging the undisclosed portions of Client Order 2, Morgan Stanley violated NYSE Arca Rule 6.49-O(b).

8. On July 18, 2016, a Morgan Stanley trader received a client order to buy 20,000 call options of a certain exchange-traded fund ("GHI") and sell 20,000 GHI put options ("Client Order 3"). The firm trader sliced Client Order 3 into three legs (2,500 contracts, 2,500 contracts, and 15,000 contracts), and transmitted each leg separately to another broker-dealer, with instructions to cross. Based on Morgan Stanley's calculated net delta, 2,500 contracts were equivalent to 142,000 GHI equity shares. After disclosure of the first leg to the trading crowd, but prior to disclosure of the second leg to the trading crowd, the Morgan Stanley trader bought 500,000 shares of GHI to facilitate Client Order 3, and thereby bought more GHI shares than needed to hedge the disclosed portion of Client Order 3. By improperly pre-hedging the undisclosed portions of Client Order 3, Morgan Stanley violated NYSE Arca Rule 6.49-O(b).

9. On November 21, 2016, a Morgan Stanley trader received a client order to buy 20,000 put options of a certain exchange-traded fund ("JKL") ("Client Order 4"). MSCO sliced the 20,000-contract order into multiple legs and transmitted each leg separately to another broker-dealer, with instructions to cross. Of the initial 2,500-contract leg, Morgan Stanley facilitated 2,250 contracts. Based on Morgan Stanley's calculated net delta, 2,250 contracts were equivalent to 58,500 JKL equity shares. After disclosure of

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[6] QCC orders are part of a multi-leg strategy that involves both stocks and options and consists of two or more legs, one of which is an NMS stock, effected at a price that has been agreed to by the parties, and the execution of one component is contingent upon the execution of all other components at or near the same time. Additionally, the components must bear a derivative relationship to one another and constitute a full hedge against each other without regard to prior existing positions. QCCs allow institutional brokers to cross these block orders electronically without exposing them to the market, as long as the order is priced at or better than the National Best Bid/Offer.

[7] Delta is a theoretical estimate of how much an option's premium may change given a $1 move in the underlying stock. For example, if a stock price increases by $1 and an option has a delta of .50, then the option price will increase by $0.50. The equivalent number of equity shares overlying an option is calculated by multiplying the delta of the option by the number of options owned. Delta is computed using an option-pricing model and offers a theoretical estimate. Net delta is the sum of the delta values of long options, less the delta values of short options.

the first leg to the trading crowd, but prior to public disclosure of the subsequent legs to the trading crowd, the Morgan Stanley trader sold 100,000 shares of JKL to facilitate Client Order 4, and thereby sold 41,500 more JKL shares than needed to hedge the disclosed portion of the Client Order 4. The Morgan Stanley trader continued to over-hedge by selling more shares of JKL equity than needed to hedge the disclosed portions of Client Order 4. By improperly pre-hedging the undisclosed portions of Client Order 4, Morgan Stanley violated NYSE Arca Rule 6.49-O(b).

10. On March 9, 2017, a Morgan Stanley trader received a client order to buy 6,842 put index options ("MNO") ("Client Order 5"). On a telephone call that took place between 8:30:40 and 8:33:42, Morgan Stanley sent Client Order 5 to another broker-dealer for execution, indicating its interest to facilitate 2,000 of the 6,842 contracts. Between 8:32:45 and 8:32:54, after Morgan Stanley had received Client Order 5, but prior to full disclosure to the trading crowd of the material terms and conditions of Client Order 5, the Morgan Stanley trader hedged his anticipated facilitation of Client Order 5 by buying for a firm account 20,000 put options of an exchange-traded fund that is directly correlated to MNO, of which 252 executed on NYSE Arca. By engaging in the foregoing conduct, Morgan Stanley violated NYSE Arca Rule 6.49-O(b).

11. On April 27, 2017, a Morgan Stanley trader received a client order to buy 10,000 put options of a certain exchange-traded fund ("PQR") ("Client Order 6"). During a telephone call from 11:53:07 to 11:53:18, the Morgan Stanley trader sent Client Order 6 to another broker-dealer for execution, with instructions to cross. At approximately 11:53:26, after Morgan Stanley had received Client Order 6, but prior to full disclosure to the trading crowd of the material terms and conditions of Client Order 6, the Morgan Stanley trader hedged its anticipated facilitation of Client Order 6 by selling for a Firm account 250,000 shares of PQR. By engaging in the foregoing trading activity, Morgan Stanley violated NYSE Arca Rule 6.49-O(b).

12. In sum, on the Trade Dates, Morgan Stanley engaged in improper anticipatory hedging, all of which violated NYSE Arca Rule 6.49-O(b).

Violation of NYSE Arca Rule 11.18(b) (Supervision)

13. Under NYSE Arca Rule 11.18(b), firms must have supervisory systems in place that are "reasonably designed to ensure compliance with applicable federal securities laws and regulations and NYSE Arca rules."

14. Though Morgan Stanley had daily, automated post-trade surveillance that monitored for potential improper anticipatory hedging, the firm's surveillance was not reasonably designed to ensure compliance with NYSE Arca Rule 6.49-O(b). Specifically, the post-trade surveillance parameters that the firm had in place were overly broad and therefore were not reasonably designed to generate sufficient alerts for review to detect potential

improper anticipatory hedging, including for review of most of the anticipatory hedging that occurred on the Trade Dates.[8]

15. As a result, Morgan Stanley violated NYSE Arca Rule 11.18(b).

B. The firm also consents to the imposition of the following sanctions:

A censure, disgorgement of $2,817, and a fine of $144,983.

Acceptance of this AWC is conditioned upon acceptance of similar settlement agreements in this and another related matter between the firm and each of the following self-regulatory organizations: NYSE American LLC, The Nasdaq Options Market LLC, Nasdaq ISE, LLC, Nasdaq BX, Inc., Nasdaq GEMX, LLC, BOX Exchange, LLC, Cboe Exchange Inc., Cboe C2 Exchange, Inc., Miami International Securities Exchange and MIAX PEARL, LLC.

The firm agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. The firm has submitted a Method of Payment Confirmation form showing the method by which it will pay the fine imposed.

The firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter. If the firm fails to make any payments as required in connection with this AWC on a timely basis, the firm agrees that any amounts owed to it by the Exchange or any of its registered U.S. Securities exchange affiliates may be used to satisfy any payments owed by the firm pursuant to this AWC.

The firm agrees that it shall not seek or accept, directly or indirectly, reimbursement or indemnification from any source, including but not limited to payment made pursuant to any insurance policy, with regard to any fine amounts that the firm pays pursuant to this AWC, regardless of the use of the fine amounts. The firm further agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with regard to any federal, state, or local tax for any fine amounts that Respondent pays pursuant to this AWC, regardless of the use of the fine amounts.

The sanctions imposed herein shall be effective on a date set by NYSE Regulation staff.

[8] Since the Trade Dates, Morgan Stanley has enhanced its post-trade surveillance parameters to detect more instances of potential improper anticipatory hedging.

II.

WAIVER OF PROCEDURAL RIGHTS

The firm specifically and voluntarily waives the following rights granted under the NYSE Arca's Code of Procedure:

A. To have a Formal Complaint issued specifying the allegations against the firm;

B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;

C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and

D. To appeal any such decision to the Exchange's Board of Directors and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the firm specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Regulatory Officer of NYSE Arca; the Exchange's Board of Directors, Disciplinary Action Committee ("DAC") and Committee for Review ("CFR"); any Director, DAC member or CFR member; Counsel to the Exchange Board of Directors or CFR; any other NYSE Arca employee; or any Regulatory Staff as defined in Rule 10.9120 in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

The firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 10.9143 or the separation of functions prohibitions of Rule 10.9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

The firm understands that:

A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the Chief Regulatory Officer of NYSE Arca, pursuant to NYSE Arca Rule 10.9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the firm; and

C. If accepted:

1. The AWC shall be sent to each Director and each member of the Committee for Review via courier, express delivery or electronic means, and shall be deemed final and shall constitute the complaint, answer, and decision in the matter, 25 days after it is sent to each Director and each member of the Committee for Review, unless review by the Exchange Board of Directors is requested pursuant to NYSE Arca Rule 10.9310(a)(1)(B).

2. This AWC will become part of the firm's permanent disciplinary record and may be considered in any future actions brought by NYSE Arca, or any other regulator against the firm;

3. NYSE Arca shall publish a copy of the AWC on its website in accordance with NYSE Arca Rule 10.8313;

4. NYSE Arca may make a public announcement concerning this agreement and the subject matter thereof in accordance with NYSE Arca Rule 10.8313; and

5. The firm may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The firm may not take any position in any proceeding brought by or on behalf of NYSE Arca, or to which NYSE Arca is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the the firm's (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which NYSE Arca is not a party.

D. A signed copy of this AWC and the accompanying Method of Payment Confirmation form delivered by email, facsimile or other means of electronic transmission shall be deemed to have the same legal effect as delivery of an original signed copy.

E. The firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NYSE Arca, nor does it reflect the views of NYSE Regulation or its staff.

The undersigned, on behalf of the firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that it has agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the firm to submit it.

June 5, 2020
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Date

Morgan Stanley & Co. LLC,
Respondent

By: S. Anthony Taggart
S. Anthony Taggart
Managing Director and Counsel

Reviewed by:

Chris Kemnitz
____
Counsel for Respondent

Christian Kemnitz
Joseph Platt
Katten Muchin Rosenman LLP
525 W. Monroe Street
Chicago, IL 60661

Accepted by FINRA

June 8, 2020
____
Date

Elyse D. Kovar
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Elyse D. Kovar, Senior Counsel
Michael Zmora, Senior Counsel
Department of Enforcement

Signed on behalf of NYSE Arca, Inc. by delegated authority from the Chief Regulatory Officer of NYSE Arca, Inc.