

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 88856 / May 12, 2020**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 5499 / May 12, 2020**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-19793**

**In the Matter of**

**Morgan Stanley Smith Barney  
LLC,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTIONS 203(e) AND 203(k) 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 Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”) and Sections 203(e) and 203(k) 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 (the “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 Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) 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 finds that:

#### Summary

1. These proceedings arise out of marketing and client communications related to the services rendered and costs incurred in MSSB's retail wrap fee programs, which were misleading to certain clients, and MSSB's failure to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act. MSSB is a sponsor of wrap fee programs in which retail clients can select one or more third-party sub-advisers ("wrap managers") to make investment decisions in the clients' account. Clients pay MSSB an asset-based "wrap fee" in exchange for a range of services, including investment advice and trade execution through MSSB.

2. From at least October 2012 until June 2017 (the "Relevant Period"), MSSB negligently provided incomplete and inaccurate information regarding the trade execution services provided by MSSB and the transaction-based execution costs incurred by clients in wrap fee program accounts, which was misleading to certain retail clients. This information was communicated through various means and indicated that MSSB executed most client trades and clients did not incur transaction-based charges. However, as MSSB was aware, some wrap managers directed most, and sometimes all, client trades to third-party broker-dealers for execution, which resulted in certain clients paying transaction-based charges that were not visible to them. Accordingly, certain MSSB clients were unaware that they regularly paid execution costs in addition to MSSB's wrap fee and paid MSSB a wrap fee that included execution services rarely, if ever, rendered by MSSB. Moreover, on occasion, wrap managers directed trades to MSSB-affiliated broker-dealers in which clients incurred transaction-based charges in violation of MSSB's affiliate trading policies without detection by MSSB. As a result of MSSB's conduct, certain MSSB clients lacked complete and accurate information needed to assess the value of the services received in exchange for the wrap fee paid to MSSB and the costs associated with their accounts.

#### Respondent

3. MSSB is a Delaware limited liability company headquartered in Purchase, New York. MSSB has been registered with the Commission as both a broker-dealer and an investment adviser since May 2009. MSSB is a wholly owned subsidiary of Morgan Stanley Smith Barney Holdings LLC, and an indirect wholly owned subsidiary of Morgan Stanley, whose shares are traded on the New York Stock Exchange. During the Relevant Period, MSSB was one of the largest sponsors of wrap fee programs in the country.

## Background

4. Wrap fee program accounts are advisory accounts in which the client pays an asset-based “wrap fee” that covers both investment advice and brokerage services, including trade execution. In its marketing materials, MSSB stated that wrap fee accounts offer clients professional investment advice, trade execution and other services with a “transparent” fee structure that streamlines and simplifies client expenses. According to MSSB’s Form ADV Wrap Fee Program Brochure (“Form ADV”), the wrap fee that MSSB charged to clients was negotiable based on a number of factors, including “the range of services” provided by MSSB.

5. Clients in MSSB’s separately managed account (“SMA”) wrap fee programs select one or more wrap managers to make investment decisions for the client on a discretionary basis and to place orders for execution. The wrap fee charged by MSSB covers the cost of order execution when the wrap manager directs the trade to MSSB. MSSB, however, permits wrap managers to “trade away” from MSSB to seek best execution for the trades.

6. MSSB generally understood its wrap managers’ trading practices and the types of trades that likely would be traded away. For example, as MSSB was aware, many managers traded away their large program trades, which are trades for all clients pursuant to the wrap manager’s investment strategy, and only executed with MSSB their small maintenance trades, which are client-specific trades occasioned by client choices such as depositing funds into or withdrawing funds out of the client’s account.

7. Some, but not all, third-party broker-dealers charged MSSB’s wrap clients with transaction-based execution costs, which were in addition to MSSB’s wrap fee. These costs were embedded into the price of the security and not separately disclosed to clients. When wrap managers traded away from MSSB and directed trades to an MSSB-affiliated broker-dealer for execution, managers were required, pursuant to MSSB’s affiliate trading policies, to place the trade with instructions that wrap clients were not to be charged transaction-based costs.

8. MSSB historically collected information regarding wrap trades that wrap managers executed with broker-dealers other than MSSB. MSSB used its own proprietary system to receive trade details from wrap managers who traded away, which was configured to accept a net price and did not require the wrap manager to report the amount of any transaction-based execution costs charged to MSSB clients.

### ***Marketing and Client Communications***

9. During the Relevant Period, MSSB provided materially misleading information regarding the trade execution services provided by MSSB and costs incurred by certain wrap fee program clients. In particular, MSSB’s marketing and client communications gave the misimpression to certain clients that MSSB executed most of the client’s trades and, while additional costs were possible, the client did not actually incur them.

10. For example, MSSB's marketing materials stated that MSSB wrap accounts offered fee "transparency" and that its wrap fee programs offered access to highly regarded investment managers "while streamlining and simplifying the expense associated with such a portfolio." However, for clients who selected wrap managers that traded away from MSSB on a regular basis with embedded transaction-based charges, execution expenses were not visible to the client.

11. Similarly, MSSB trained its financial advisors ("FAs") to tell clients that one of the benefits of a wrap account was "fee transparency," and that brokerage accounts typically charge transaction-based fees and advisory accounts charge an asset-based fee. Account opening documents also stated that in a brokerage account, the client's "total costs will generally increase or decrease as a result of the frequency of transactions in the account," but in "an investment advisory account your total costs will generally not increase or decrease as a result of the frequency of transactions in the account." However, as MSSB was aware, some wrap managers traded away most, and sometimes all, of their trades, which resulted in certain clients regularly incurring embedded transaction-based costs in addition to the asset-based wrap fee. These costs were not transparent to clients.

12. MSSB prepared trade confirmations and account statements for its wrap fee program clients. During the Relevant Period, MSSB trade confirmations and account statements contained the same information whether the wrap manager's trades were executed by MSSB or traded away. For all trades in an MSSB wrap fee account, even for trades that MSSB did not execute, the clients' trade confirmations and account statements stated that MSSB "acted as agent" with respect to the trade and did not indicate to clients when or if additional transaction-based costs were incurred.

13. Moreover, certain of MSSB's client agreements during the Relevant Period stated that MSSB expected that it would execute "most" client trades, and from 2012 to March 2015, MSSB's Forms ADV stated that MSSB would "usually" execute client trades. As MSSB was aware, however, several of its wrap managers did not "usually" execute trades with MSSB. Rather, certain managers rarely, and sometimes never, executed trades with MSSB. Thus, whether these statements were accurate depended on the manager selected by the client, and for certain managers, these statements were not accurate.

14. MSSB's Forms ADV and client agreements stated that the wrap fee did not cover certain costs, such as brokerage commissions incurred for trades not executed through MSSB. However, during the Relevant Period, MSSB did not disclose that these additional costs would not be visible to the wrap fee program client on the client's account documents.

15. In March 2015, MSSB updated its Form ADV to include a new disclosure about trading away. While this disclosure provided additional information regarding trading practices of wrap managers, including that certain wrap managers traded away most or all of the time, from March 30, 2015 until March 30, 2017, this disclosure stated in bold font: "[O]nce you have selected a manager, you should carefully review the manager's trading for your account to understand any additional trading costs that may be incurred." Clients, however, did not have

this information available to them because execution costs from trading away were not visible to clients on their account documents or elsewhere.

16. In 2015, MSSB asked its wrap managers to report the dollar-weighted percentage of the trades that the manager traded away from MSSB and the costs associated with that trading. In December 2015, MSSB placed a disclosure on its website entitled “Step-out Trade Information,” which included a chart that reported the dollar-weighted percentages that managers traded away based on the information provided by the wrap managers.

17. Text associated with the chart noted the possibility that additional costs could be incurred, but it did not include the cost information that each wrap manager had reported to MSSB and it did not tell clients that the additional costs would not be visible to them. Moreover, this text repeated the language from MSSB’s 2015 Form ADV update that advised clients to “carefully review” the trading in their account to understand additional costs incurred. Clients, however, did not have this information available to them.

18. Taken together, a reasonable client reviewing MSSB’s marketing and client communications, along with his or her account documents, could conclude that while additional costs were possible, they were not, in fact, incurred in the ordinary course because MSSB usually executed the client’s trades. For certain clients, however, this conclusion was inaccurate as their managers elected to execute trades away from MSSB most or all of the time and these clients regularly incurred additional costs.

19. As the result of MSSB’s conduct, certain clients in MSSB’s retail wrap fee programs lacked complete and accurate information needed to assess the value of the services rendered by MSSB and the costs incurred in wrap fee program accounts.

### ***Policies and Procedures***

20. MSSB failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act in connection with trading away. In particular, MSSB failed to adopt policies and procedures reasonably designed to monitor, collect and disseminate complete and accurate information related to trading away, the trade execution services rendered by MSSB and the costs incurred by clients in order to ensure that its marketing and client communications were not misleading.

21. Moreover, in connection with trading away by wrap managers, MSSB failed to adopt and implement affiliate trading policies reasonably designed to prevent violations of the Advisers Act. Although MSSB prohibited its wrap managers from executing trades with MSSB affiliates that would result in the client paying transaction-based compensation to another Morgan Stanley company in addition to MSSB’s wrap fee, MSSB did not adopt and implement written policies reasonably designed to monitor wrap managers for compliance with these restrictions. As a result, some managers circumvented these restrictions without detection by MSSB causing certain clients to pay Morgan Stanley twice for order execution.

## Violations

22. As a result of the conduct described above, MSSB willfully<sup>1</sup> violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in any transaction, practice or course of business that operates as a fraud or deceit upon a client or prospective client. Scierer is not required to establish a violation of Section 206(2), but rather a violation may rest on a finding of negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194-95 (1963)).

23. As a result of the conduct described above, MSSB willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require, among other things, that a registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder by the adviser and its supervised persons.

## MSSB's Remedial Efforts

24. In determining to accept the Offer, the Commission considered certain remedial acts undertaken by MSSB, including the following:

- a. MSSB has enhanced its Form ADV and client agreements regarding trading away and the associated costs;
- b. MSSB has required its wrap managers to report to it the dollar-weighted percentage of the trades that the manager executed away from MSSB and the average cost associated with these trades;
- c. MSSB has placed on its website a chart that reflects the information reported by its wrap managers regarding the dollar-weighted percentage of the trades that wrap managers executed away from MSSB and the average cost associated with these trades;
- d. MSSB has enhanced its account statements and trade confirmations to: (1) reflect when a trade is a "step-out trade;" (2) include language that explains to clients that when a trade is marked as a "step-out trade," the client may have been assessed trading related costs by another broker-dealer, which are in addition to

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<sup>1</sup> "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).

the wrap fee; and (3) direct clients to MSSB's Annual Investment Strategy Step-Out Disclosure to obtain additional information;

- e. MSSB has implemented training for its FAs regarding trading away by wrap managers and the associated costs and has instructed FAs that they "are responsible for helping the client understand how step outs can affect their fees . . . [and] should consider his or her suitability review and the additional trading costs that a client may potentially incur when recommending a strategy that steps out more frequently;"
- f. MSSB has enhanced its affiliate trading policies and procedures and refunded to clients the transaction-based charges paid to MSSB's affiliates as the result of wrap managers trading with MSSB affiliates in violation of MSSB's policies;
- g. MSSB has sent to current clients information describing trading away frequency and associated costs and has notified clients that they can contact their FA for more information regarding the costs incurred by the client;
- h. MSSB has adopted and is implementing written policies and procedures to provide information to new clients at account opening regarding trading away frequency and average costs; and
- i. MSSB has adopted and is implementing written policies and procedures to review all communications with clients and prospective clients to ensure that statements in such communications related to trade execution services rendered by MSSB and costs incurred by clients are accurate for all clients regardless of the wrap manager or investment strategy selected by the client.

#### IV.

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

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

A. Respondent MSSB cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

B. Respondent MSSB is censured.

C. Respondent MSSB shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of \$5 million to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

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:

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 Melissa R. Hodgman, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the penalties referenced in paragraph C. above. 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