



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
CORPORATION FINANCE

December 9, 2024

Elizabeth A. Marino, Esq.
Sidley Austin LLP
60 State Street, 30th Floor
Boston, MA 02109

Re: **Morgan Stanley Smith Barney LLC**
Waiver of disqualification pursuant to Rule 506(d)(2)(ii) of Regulation D

Dear Elizabeth Marino:

This is in response to your letter dated December 6, 2024 (“Waiver Letter”), written on behalf of Morgan Stanley Smith Barney LLC (“MSSB”) and constituting an application for a waiver of disqualification under Rule 506(d)(2)(ii) of Regulation D under the Securities Act of 1933 (“Securities Act”). In the Waiver Letter, MSSB requests relief from any disqualification that will arise as to MSSB under Rule 506 of Regulation D under the Securities Act as a result of entry of the Commission’s order on December 9, 2024 against MSSB 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 (the “Order”).

Based on the facts and representations in the Waiver Letter and assuming that MSSB complies with the Order, we have determined that MSSB has made a showing of good cause under Rule 506(d)(2)(ii) of Regulation D that it is not necessary under the circumstances to deny it reliance on Rule 506 of Regulation D by reason of the entry of the Order. Accordingly, the relief requested in the Waiver Letter is hereby granted on the condition that MSSB complies with the terms of the Order. Any different facts from those represented or MSSB’s failure to comply with the terms of the Order would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

Sincerely,

/s/ M. Hughes Bates

M. Hughes Bates
Chief, Office of Enforcement Liaison
Division of Corporation Finance



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December 6, 2024

By Email

Office of Enforcement Liaison
Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: *Morgan Stanley Smith Barney LLC*

Dear Office of Enforcement Liaison:

We are writing on behalf of Morgan Stanley Smith Barney LLC (“MSSB” or the “Firm”) in connection with the anticipated settlement with the United States Securities and Exchange Commission (“SEC” or “Commission”) relating to *In the Matter of Morgan Stanley Smith Barney LLC*. The settlement will result in an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the “Order”) against MSSB. The Order requires that the Firm comply with certain undertakings, discussed herein, over a period of approximately two years. Therefore, as discussed below, absent a waiver, MSSB will be disqualified with respect to offerings pursuant to Rule 506 of Regulation D under the Securities Act of 1933 (“Securities Act”) until such time as it satisfies the undertakings enumerated in the Order. We hereby respectfully request a waiver of any disqualification that will arise pursuant to Rule 506 of Regulation D under the Securities Act with respect to MSSB or any of its affiliates as a result of the entry of the Order. MSSB respectfully submits that the conduct in the Order involved a very small fraction of MSSB’s Financial Advisor population and that MSSB has demonstrated through its actions that it has used the rare incidents of misconduct as learning opportunities to understand new fraud threats and design new controls to combat those threats.¹

I. INTRODUCTION

MSSB is dually registered with the Commission as a broker-dealer and investment adviser. MSSB is a wholly owned indirect subsidiary of Morgan Stanley.

¹ The conduct in the Order represents less than three hundredths of one percent of MSSB’s Financial Advisor population.

The Order will find that MSSB failed (i) to adopt and implement policies and procedures reasonably designed to prevent and detect misappropriation by four MSSB registered representatives and/or investment advisory representatives – Michael Carter, Jesus Rodriguez, Douglas McKelvey and Gary Chang (the “FAs”) - from client and customer accounts (a) by means of unauthorized Automated Clearing House (“ACH”) payments that were externally initiated; and/or (b) using unauthorized cash wire transfers from multiple unrelated customer or client accounts of the same FA to the same third-party external account; and (ii) to reasonably supervise the FAs.

The Order will find that MSSB (i) willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and (ii) failed reasonably to supervise four FAs, within the meaning of Section 15(b)(4)(E) of the Exchange Act and Section 203(e)(6) of the Advisers Act, with a view to preventing their violations of the federal securities laws.

Without admitting or denying the findings in the Order, except as to the Commission’s jurisdiction over MSSB and the subject matter of the proceeding, MSSB will consent to the issuance of the Order and to (i) cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, (ii) be censured, (iii) pay a civil money penalty in the amount of \$15 million, and (iv) comply with certain undertakings enumerated in the Order.

Background

As discussed in more detail herein, MSSB entered into a 2018 settlement with the Commission related to Barry Connell, a financial advisor who misappropriated funds from clients by initiating third-party disbursements from client accounts of outgoing wire transfers and journals of up to \$100,000 per day per account based on his attestation on an internal electronic form that he had received a verbal request from the client by phone or in-person and providing certain details about the request. Following that settlement, the Firm undertook a review of its control framework regarding the detection and prevention of financial advisor fraud and made a substantial number of enhancements to its system of controls. The Firm then retained a law firm, Sidley Austin LLP (“Sidley”), to assess the adequacy of its enhanced policies and procedures. As part of Sidley’s review, PricewaterhouseCoopers (“PwC”) was retained to conduct testing of MSSB’s enhanced policies and procedures. During this review, but before the Firm had completed implementation of substantial enhancements to its policies and procedures, the Firm discovered the conduct of FA Michael Carter, who between February 2007 and May 2019 (before the enhancements were implemented) misappropriated funds from clients with whom he had familial and personal relationships by going to great lengths to circumvent MSSB’s anti-fraud controls. Carter effected his fraud through unauthorized wire transfers and the opening of an unauthorized loan account that was controlled by Carter and used to divert client funds for

personal use (the matter is described in more detail below in Section II.7).² The Firm remediated the issues surrounding Carter. Thereafter, PwC and Sidley completed their review, the Firm remediated the identified minor exceptions and Sidley concluded, based on its assessment of the implementation and adequacy of the Firm's policies and procedures, including the testing conducted by PwC, that the Firm's relevant policies and procedures were adequate and sufficient to provide reasonable assurance of its compliance with all SEC regulations and standards of the self-regulatory organizations ("SROs") of which the Firm was a member.

Subsequently, in 2021, the Firm discovered that FA Rodriguez misappropriated client funds from multiple clients, using particular techniques not previously seen by the Firm. He committed his fraud and evaded Firm controls predominantly by (i) journaling funds through unrelated client accounts to MSSB accounts affiliated with his close family and associates, and (ii) transferring funds directly from client accounts to pay for his own personal expenses via wires and Receiving Depository Financial Institution ("RDFI") ACHs. MSSB conducted a thorough investigation into the circumstances of FA Rodriguez's misconduct and, at significant expense to the Firm, engaged third-party consultants AlixPartners and Capital Forensics to conduct a specialized transactional analysis for any suspicious activity and perform background research related to the misconduct, and conducted extensive email review and open-source research on the parties involved in the potentially suspicious transactions. Further, in response to the incident, the Firm proactively implemented additional controls relating to RDFI ACHs and enhanced its existing controls around internal "journal" transfers between multiple, unrelated clients to the same MSSB account. In early 2022, MSSB retroactively applied its new RDFI ACH control and, as a result, identified and self-reported the misconduct of FAs McKelvey and Chang.³ It is important to note that the misconduct of FAs Rodriguez, McKelvey and Chang differed significantly from the conduct of FA Carter as it primarily involved ACH payments that were initiated at third party institutions and internal transfers between unaffiliated clients, which made the fraudulent activity more challenging to detect and prevent.

Subsequent to the discovery of the Rodriguez matter, in July 2022, MSSB engaged a highly regarded, independent third-party consultant (the "Consultant"), a business unit of IBM Consulting, to conduct a front-to-back review and assessment of MSSB's internal fraud and asset movement processes, related controls, and implemented or planned enhancements. MSSB provided the Consultant with a voluminous record, including policies, procedures, and documents related to prior incidents of FA misappropriation. Ultimately, the Consultant

² See *In the Matter of Morgan Stanley Smith Barney LLC*, Administrative Proceeding File No. 18566 (June 29, 2018).

³ FA McKelvey misappropriated funds from two client accounts held by his family members through RFDI ACHs and Express Credit Line draws. Similarly, FA Chang misappropriated funds from four client accounts by linking his external accounts to client accounts to pay for his personal expenses and bills via RDFI ACHs.

concluded that MSSB's existing controls were reasonably designed to ensure MSSB was in compliance with relevant rules and regulations and were consistent with that of peer institutions. The Consultant found no systemic deficiencies in MSSB's control environment relating to asset movement and internal fraud and its selected testing of certain existing controls did not result in findings of material deficiency. The Consultant proposed certain recommendations to further enhance MSSB's comprehensive control framework, explaining these recommendations would serve only to strengthen MSSB's control environment for asset movement and the mitigation of internal fraud. MSSB has assessed the Consultant's proposed enhancements and is in the process of addressing all of the recommendations – the vast majority of which have been implemented.

II. DISCUSSION

Absent a waiver, the entry of the Order will disqualify MSSB, affiliated entities, and certain other issuers from relying on Rule 506 of Regulation D under the Securities Act, pursuant to Rule 506(d)(1)(iv)(B), which provides that issuers and certain covered persons may not rely on Rule 506 of Regulation D when the issuer and/or covered persons are, in relevant part, the subject of an SEC order entered pursuant to Section 15(b) of the Exchange Act and/or Section 203(e) of the Advisers Act that places limitations on the activities, functions or operations of such person. Since the Order will be issued pursuant to Section 15(b) of the Exchange Act and Section 203(e) of the Advisers Act and contains undertakings, absent a waiver, MSSB and third parties that engage MSSB to act in a covered capacity outlined in Rule 506 of Regulation D would be unable to rely on Rule 506 until the completion of the undertakings enumerated in the Order that it will be ordered to complete within approximately two years of the entry of the Order.

The Commission, or the Division of Corporation Finance (the "Division"), acting pursuant to delegated authority, has the authority to waive this disqualification upon a showing of good cause that such disqualification is not necessary under the circumstances.⁴ MSSB respectfully requests that the Commission do so on the following grounds:

1. *The Violations in the Order Do Not Arise Out of the Offer or Sale of Securities*

The conduct set forth in the Order does not involve the offer or sale of securities. Specifically, the conduct described in the Order arises out of MSSB's alleged failure to adopt and/or implement policies and procedures reasonably designed to prevent four rogue MSSB employees from misappropriating funds in client accounts.

⁴ See Rule 506(d)(2)(ii).

As described in Section II.5 herein, in connection with the conduct described in the Order, the Firm engaged a Consultant in 2022 to conduct a comprehensive nine-month review and assessment of MSSB's internal fraud and asset movement processes, related controls, and implemented or planned enhancements. Ultimately, the Consultant concluded that MSSB's existing controls were reasonably designed to ensure MSSB was in compliance with relevant rules and regulations and were consistent with that of peer institutions. The Consultant proposed certain recommendations to further strengthen MSSB's comprehensive control environment for asset movement and the mitigation of internal fraud. MSSB is addressing all of the Consultant's recommendations—the vast majority of which have been implemented. The few recommendations that remain in progress are tied to extensive technological enhancements that require significant technological build out and analysis.⁵ Furthermore, the conduct described in the Order involved rare incidents of misappropriation by four financial advisors, which represents a very small fraction of the Firm's financial advisor population. Based on the foregoing, the Firm's Chief Compliance Officer is assured that the conduct described in the Order is not indicative of a widespread governance issue throughout the Firm.

2. *The Misconduct Does Not Involve Violations of Scier-er-Based Statutory or Regulatory Provisions and Does Not Involve a Criminal Proceeding*

The violations in the Order against MSSB are not criminal in nature and do not involve scier-er-based fraud or other scier-er-based violations.

3. *Duration of the Misconduct*

The conduct described in the Order arises out of MSSB's failure, from 2007 to 2022 to adopt policies and procedures reasonably designed to prevent MSSB personnel from misusing and misappropriating funds in client accounts, which contributed to its failure to prevent or detect four FAs from misappropriating funds from client accounts. As described herein and as noted in the Order, MSSB has made significant enhancements during the entire period at issue, including implementation of an enhancement in 2022 that identified the conduct of two of the four FAs at issue. Moreover, the Firm proactively engaged an independent third-party Consultant in 2022 to conduct a front-to-back comprehensive review and assessment of all money-movement related areas. MSSB is currently in the process of implementing additional enhancements in connection with the Consultant's recommendations.

⁵ MSSB has implemented all of the Consultant's recommended enhancements with the exception of a limited number of remaining enhancements, for which it has provided Commission staff with a detailed plan and schedule for their implementation.

Upon learning of each of the FAs' misconduct, MSSB promptly terminated the FA, addressed client harm, and self-reported the misconduct to the SEC and other law enforcement agencies.

4. *Responsibility for the Misconduct*

In assessing responsibility for the misconduct, the Division of Corporation Finance has stated that it would also consider, among other factors, whether (1) "the misconduct reflects more broadly on the entity as a whole" or (2) "the tone at the top of the party seeking the waiver condoned, encouraged or did not address the misconduct, or actions or omissions by the party seeking the waiver, or any of its affiliates, obstructed the regulatory or law enforcement investigation."⁶

The Commission has not sought to charge any individuals currently associated with MSSB with violations in connection with the conduct underlying the Order, and we understand that no such charges are forthcoming. Rather, the four FAs at issue in the Order represent *less than three hundredths of a percent* of MSSB's Financial Advisor population and none of them held any leadership or management positions at MSSB. Moreover, once MSSB management became aware of the conduct, swift action was taken to terminate these employees, remediate client harm and inform the SEC and other applicable authorities.

5. *MSSB Has Taken Remedial Steps and Will Take Additional Steps*

MSSB has taken, and continues to take, substantial remedial steps, on its own initiative, to address the conduct at issue in the Order and it will take additional remedial steps to comply with the undertakings enumerated in the Order.

As noted in the Order, upon discovering each of the relevant instances of fraud, MSSB promptly conducted an internal investigation, terminated the FA, conducted client remediation efforts, and reported the fraud to the SEC and other law enforcement agencies. MSSB also compensated affected clients. Over the past several years, MSSB has developed enhanced policies relating to preventing, detecting, and investigating internal fraud, some of which have been implemented as part of the Firm's ordinary course review and others based on information learned from these unfortunate incidents of misconduct. The policies and procedures relate to, among other areas, the FA onboarding process; training related to fraud; client contact, authentication, and outreach; third-party disbursements; securities-backed loans and lines of credit offered to MSSB clients; FA outside business interests; fraud reviews and detection;

⁶ See Division of Corporation Finance, Waivers of Disqualification under Regulation A and Rules 505 and 506 of Regulation D (Mar. 13, 2015).

electronic communications surveillance; and the Firm's process for reviewing and responding to incidents of internal fraud. Specifically, among other things, MSSB:

- Enhanced its Pre-Hire Committee review process to include review of employees seeking to make internal transfers into an FA role.
- Enhanced its fraud prevention and education efforts relating to elderly/vulnerable clients.
- Enhanced authentication requirements around changes to a client's contact information.
- Implemented near-real time email notifications for address changes and physical mail notification, in addition to email notice, for any change in eDelivery via Morgan Stanley Online.
- Enhanced client callback processes for outgoing wire transfers and for extensions of credit.
- Enhanced fraud surveillance models and alerts for monitoring potentially suspicious FA and client account activity, including certain online activities, changes to client contact information and certain commonalities across unrelated households.
- Enhanced controls around journal surveillance to identify instances of internal transfers between multiple unrelated clients to the same MS account.
- Implemented a fraud control to identify instances where an FA's name is in the receiver field of a RDFI ACH debit transaction from an account that does not belong to the FA.
- Improved detection and prevention of undisclosed outside business activities and private investments, including FAs soliciting clients to purchase securities not held or offered by the Firm ("selling away") and use of an undisclosed outside business entity for an improper purpose.
- Enhanced electronic communication surveillance of FA communications based on certain keywords and other features potentially indicative of fraud.
- Adopted a Wealth Management Internal Fraud Incident Management Procedure that formalizes a five-step process for reviewing and responding to internal fraud incidents, including identification and containment, investigation, resolution, post event review, and escalation, governance and communication.

In addition, as referenced above, MSSB engaged a Consultant in 2022 to conduct a comprehensive nine-month review and assessment of MSSB's internal fraud and asset movement processes, related controls, and implemented or planned enhancements. The review included:

- Targeted assessments of MSSB's asset movement policies and processes;
- Interviews and discussions with key stakeholders; and
- Testing of MSSB's internal fraud and asset movement controls.

Ultimately, the Consultant concluded that MSSB's existing controls were reasonably designed to ensure MSSB was in compliance with relevant rules and regulations and were consistent with that of peer institutions. The Consultant proposed certain recommendations to further strengthen MSSB's comprehensive control environment for asset movement and the mitigation of internal fraud. MSSB is addressing all of the Consultant's recommendations—the vast majority of which have already been implemented, as discussed in Section II.1 above.

In connection with the Order, MSSB has also agreed to implement certain undertakings including the following:

- Engage a consultant ("Compliance Consultant") to (a) conduct a comprehensive review of all available forms of third-party cash disbursements from customer and client accounts and MSSB's policies, procedures and controls for preventing and detecting conversion of client advisory or brokerage customer funds by its supervised persons through each available form, including but not limited to MSSB's implementation of recommendations from the Consultant's April 2023 report described herein, and assess whether MSSB is complying with its policies, procedures and controls in effect as of the start date of the Compliance Consultant's engagement, and whether such policies, procedures and controls are effective in achieving their stated purpose; (b) submit a written report to MSSB and the Commission staff of its findings and recommendations for changes or enhancements to the policies, procedures and controls described in paragraph 30.b.1 of the Order and a procedure for implementing the recommended changes and enhancements (the "First Report"); (c) one year from the date of the issuance of the Compliance Consultant's First Report, conduct an annual review ("Annual Review") to assess whether MSSB is complying with its then-current policies, procedures and controls, including MSSB's implementation of recommendations from the Compliance Consultant's First Report, and assess whether MSSB's then-current policies, procedures and controls are effective in achieving their stated purpose; and (d) submit a written report to MSSB and to the Commission staff of its findings and recommendations, if any, for additional changes and

enhancements to the policies, procedures and controls, and a procedure for implementing the changes and enhancements (the “Second Report”).

- Within ninety (90) days of receipt of each of the Compliance Consultant’s reports, adopt all recommendations contained in the reports, provided, however, that within thirty (30) days after the date of the applicable report, MSSB shall in writing advise the Compliance Consultant and the Commission staff of any recommendations that it considers to be unduly burdensome, impractical, or inappropriate. In the event MSSB determines that it is impracticable to adopt a recommendation within ninety (90) days solely due to timing, MSSB shall in writing advise the Compliance Consultant and the Commission staff as to the reason why timing is impracticable and propose an alternative schedule for implementation. With respect to any recommendation that MSSB otherwise considers to be unduly burdensome, impractical, or inappropriate, MSSB need not adopt that recommendation at that time but shall instead propose in writing an alternative policy or procedure designed to achieve the same objective or purpose as that recommended by the Compliance Consultant. MSSB shall engage in good faith negotiations with the Compliance Consultant in an effort to reach agreement on any recommendations objected to by MSSB. In the event that MSSB and the Compliance Consultant are unable to agree on an alternative proposal within thirty (30) days, MSSB shall abide by the determinations of the Compliance Consultant.
- Certify in writing compliance with the undertakings.

MSSB thus has taken and will continue to take concrete and substantial steps to remediate the conduct at issue in the Order. The steps are designed to enhance MSSB’s overall compliance program going forward.

Furthermore, as the Firm’s Regulation D business has grown over the past several years, the Firm has committed significant resources to assure compliance with Regulation D, including additional personnel, training and technology/platform enhancements. In 2023, Morgan Stanley’s Internal Audit Department conducted a review of MSSB’s alternative investments business, including MSSB’s policies and procedures related to Regulation D offerings, with satisfactory results. In early 2024, Legal and Compliance conducted a review of the Firm’s procedures surrounding its Regulation D processes and did not identify any material gaps or substantive issues. The Firm regularly reviews its Regulation D policies and procedures, implementing updates as needed, and conducts regular reviews of Regulation D policies and procedures and controls related thereto. In connection with this Application, the Firm conducted an additional assessment of the Firm’s prior reviews and its policies and procedures related to Regulation D. Based on the collective reviews described above, the Firm’s Chief Compliance

Officer believes that MSSB's policies and procedures regarding Regulation D are reasonably designed to assure compliance with Regulation D.

Accordingly, it is not necessary to disqualify MSSB and its affiliates from relying on Rule 506 in connection with an offering.

6. *Disqualification Would Have a Material and Disproportionate Impact on MSSB and its Clients*

MSSB's inability to act as a placement agent or compensated solicitor for Rule 506 offerings would have a significant adverse impact on clients and would be extremely damaging to MSSB, its affiliates, including Morgan Stanley Investment Management ("MSIM"), on funds sponsored, administered and/or advised by MSSB affiliates, funds managed by third parties (collectively, the "Funds"), and issuers of Private Placements (defined below) that have retained, or in the future may retain MSSB in connection with transactions that rely on exemptions under Rule 506(b) or (c).

MSSB currently acts, and in the future desires to continue to act, as (a) a "placement agent" for private placements of securities offered by affiliate and third-party issuers ("Private Placements"), and (b) a compensated solicitor pursuant to Fund selling agreements.

A. Effects of Disqualification on MSSB Alternative Investments Business

Although MSSB's alternative investment business has nothing to do with the conduct at issue, it would suffer significant negative consequences should a waiver be denied. The alternative investments business at MSSB consists of the marketing and distribution of private funds such as exchange funds, managed futures, single manager hedge funds, fund of funds, private equity funds and real estate funds. The MSSB alternative investments business has approximately \$165.6 billion in assets under management ("AUM"), as of June 30, 2023, and the Rule 506 business constitutes approximately 80% of the AUM. The MSSB alternative investments business employs approximately 200 dedicated professionals and dozens of additional "service provider" employees. If MSSB were disqualified from acting as a compensated solicitor or placement agent for offerings relying on Rule 506, many, if not all, such professionals would lose their jobs and MSSB would likely be forced to exit its alternative investments business.

The alternative investments business continues to grow year over year. MSSB currently acts as a compensated solicitor and/or placement agent for approximately 180 open funds and engages with hundreds of asset management partners. For the period January 2020 to October 2023, MSSB offered approximately 495 unique funds issued in reliance on Rule 506, and such

Funds raised approximately \$86.7 billion from MSSB investors.⁷ For the period 2020 through 2022, MSSB offered 65-100 new funds, each year. Of the wirehouses, MSSB has approximately 50% of the market share in the alternative investments space. MSSB is also working on funds for which it expects to act as a compensated solicitor within the next six months. Further, MSSB consistently has approximately 180 alternative investments open for investment at any given point in time.

MSSB has also served as placement agent and provided access to alternative investments for wealth management clients such as individuals, trusts, family offices, pension funds, endowments and non-taxable retirement plans, in debt and equity offerings that raised billions from MSSB accounts since 2000. As placement agent, MSSB works cooperatively with issuers to structure the Private Placements and the majority of such issuers prefer to offer their securities in reliance on Rule 506 rather than Section 4(a)(2) of the Securities Act. Reliance on Rule 506 is generally preferred over Section 4(a)(2) of the Securities Act due to the clearly delineated exemption criteria outlined in Rule 506 and related clarity regarding the universe of permissible clients in an offering made in reliance on Rule 506. Furthermore, offerings made in reliance on Section 4(a)(2) of the Securities Act must comply with the state blue sky requirements, many of which have stringent requirements regarding the number of permitted investors and disqualification provisions that largely mirror the Rule 506 of Regulation D disqualification.

MSSB is also the sole distributor for certain third-party feeder funds for its wealth management clients. Each of the feeder funds is formed solely for the purpose of investing in an affiliate or third party managed private fund and relies on Rule 506. For many of the feeder funds, such funds cannot conduct an offering under Section 4(a)(2) of the Securities Act given that the vast majority of the underlying funds elect to rely on Regulation D and are also unable to utilize a distributor that is unable to participate in an offering made in reliance on Regulation D. MSSB clients are the sole retail investors in many of the feeder funds. If MSSB were disqualified pursuant to Rule 506, the clients invested in the feeder funds would be negatively and disproportionately impacted.

Fees to MSSB from fund sales, including placement agent fees, are approximately \$2.2 billion for 2020 through 2022.

B. Effect of Disqualification on MSSB Clients

As referenced above, alternative investments offered pursuant to Rule 506 are an integral part of MSSB's product offerings to clients. Approximately 220,000 unique MSSB accounts

⁷ In addition to the 250 unique Funds issued in reliance on Rule 506, MSSB may have also offered for sale other Funds relying on Rule 506 that did not generate any sales.

hold at least one alternative investment position in their portfolios.⁸ Incorporating alternative investments into a traditional portfolio can help clients reduce overall volatility while increasing portfolio diversification, with a typically lower correlation to the market movements of traditional investments such as stocks and bonds. MSSB offers access to proprietary, affiliated and third-party Funds to approximately 520,000 MSSB households with a combined assets under management at MSSB of approximately \$3.2 trillion⁹ across approximately 3.5 million accounts. As demonstrated by the number of high-net-worth clients investing in Funds and Private Placements through their MSSB accounts, access to such products is very important to high-net-worth investors and allows such investors the ability to diversify their holdings in unique ways.

As the needs of such eligible investors and market conditions change, MSSB needs to be able to offer eligible investors new products that might more closely suit their investment objectives and current needs. If MSSB were disqualified from offering such Funds and Private Placements to its clients, clients would lose access to the types of Funds they may have accessed in the past or wish to access in the future. As a consequence, such clients may not be able to invest their portfolios as they and/or their financial advisors may see fit and, as such, may need to open new accounts at other broker-dealers or move their accounts to other brokerage firms that can offer such products to them.

Moving accounts to other brokerage firms can be very burdensome and harmful to clients because clients may hold positions that may not be easily transferred to other brokerage firms. Therefore, absent a waiver, clients would be forced to choose between maintaining multiple brokerage accounts, which many clients, especially high-net-worth clients, do not want to do for a variety of reasons, or lose access to products that would otherwise be in their best interests to meet their investment objectives and goals. For example, those clients invested in MSSB feeder funds and MSIM products may not have the ability to hold their positions outside of Morgan Stanley.

Finally, there would be significant commercial harm to MSSB if such clients (and their financial advisors) moved to other brokerage firms.

C. Effects of Disqualification on MSIM and MSIM Funds

MSSB is the primary distributor for MSIM funds and is the main retail channel for MSIM funds. Historically, MSSB client alternative fund assets account for approximately 99%

⁸ MSSB clients hold approximately 450,000 total alternative investment positions.

⁹ MSSB offers Private Placements and Funds to its qualified high net worth and institutional clients. The clients to whom MSSB offers the Funds are all accredited investors.

of MSIM's retail investor AUM. The majority of the MSIM alternative funds offered by MSSB are sold in reliance on the exemption under Rule 506.

If MSSB were disqualified pursuant to Rule 506, it would be unable to act as a compensated solicitor of any funds offered pursuant to Rule 506 and, therefore, the MSIM alternative funds would be disqualified from retaining MSSB as its compensated solicitor in connection with an offering made in reliance on Rule 506. Since MSSB is the main retail channel for the MSIM alternative funds, such funds would lose access to most of their retail investors, which represent a significant number of their investors. Currently, approximately 48,000 unique MSSB accounts hold investments in funds offered by its affiliates.¹⁰ Although MSSB would technically be permitted to act as a compensated solicitor of funds offered in reliance on Section 4(a)(2) of the Securities Act, the MSIM alternative funds would not likely be willing to offer their securities pursuant to Section 4(a)(2) due to the restrictions related to such offerings. MSIM's inability to use MSSB as its compensated solicitor would be detrimental to MSIM and the MSIM alternative funds.

7. *Prior Relief*

MSSB was previously granted one waiver from the disqualification provisions of Regulation D in connection with the matter titled *In the Matter of Morgan Stanley Smith Barney LLC* (June 29, 2018) related to a settlement with the Commission in connection with (i) MSSB's failure to adopt policies and procedures reasonably designed to prevent MSSB personnel from misusing and misappropriating funds in client accounts, from at least 2009 to 2018, by permitting financial advisors to initiate third-party disbursements from client accounts of outgoing wire transfers and journals of up to \$100,000 per day per account based on the financial advisors' attestation on an internal electronic form that the financial advisor had received a verbal request from the client by phone or in-person and providing certain details about the request; and (ii) MSSB's failure to detect or prevent one financial advisor from misappropriating funds from one client household's accounts over an approximate one year period resulting in a failure reasonably to supervise the financial advisor (the "2018 Matter").

The 2018 Matter required MSSB to comply with certain undertakings, including (1) the submission of a certification stating that its policies, procedures, systems and controls relating to preventing or detecting conversion of client advisory and customer brokerage funds by MSSB personnel through third-party cash disbursements ("Enhanced MSSB Policies") were fully operational (the "Initial Certification"), and (2) the submission of a certification as to (a) the completion of an assessment of the implementation and adequacy of the Enhanced MSSB

¹⁰ Please note that each account may hold positions in more than one affiliated fund. MSSB clients hold approximately 61,000 affiliated total alternative investment positions.

Policies, together with any other relevant MSSB policies, procedures, systems and controls relating to preventing or detecting conversion of client advisory funds by MSSB personnel through all forms of third-party cash disbursements, and (b) that after reasonable inquiry, the certifier believed the then-existing relevant MSSB Policies were adequate and sufficient to provide reasonable assurance of compliance with all relevant Commission regulations and any standards and rules of SROs registered with the Commission and of which MSSB was a member (the “Final Certification”).

In connection with the 2018 Matter, MSSB implemented substantial enhancements to its policies and procedures. Although not required by the order in connection with the 2018 Matter, MSSB retained outside counsel to assess the adequacy of its enhanced policies and procedures and retained a consultant to test its enhanced policies and procedures in preparation for its Final Certification. Prior to submitting MSSB’s Final Certification to the SEC staff in connection with the 2018 Matter, MSSB identified FA Carter’s misconduct. MSSB terminated FA Carter, investigated the incident, compensated affected clients and self reported the incident to the SEC and Department of Justice (“DOJ”). In response to this incident, MSSB undertook a closer review, in coordination with outside counsel and its consultant, to determine whether additional improvements to its controls were appropriate. As a result of those efforts, MSSB implemented additional enhancements, including with respect to extensions of credit, outside business interests, client contact and outreach, and fraud surveillance. The consultant identified certain minor exceptions and they were promptly remediated. At the conclusion of MSSB’s outside counsel review, it concluded, based on its assessment of the implementation and adequacy of MSSB’s policies and procedures, including the testing conducted by the consultant, that MSSB’s relevant policies and procedures were adequate and sufficient to provide reasonable assurance of its compliance with all relevant SEC regulations and standards of the SROs of which MSSB was a member. Upon the conclusion of such reviews, MSSB submitted its Final Certification to the SEC staff in January 2020, in connection with the 2018 Matter.

The conduct of FA Rodriguez was identified in July 2021—a year and a half after MSSB’s submission of the Final Certification in connection with the 2018 Matter.¹¹ Critically, this conduct differed significantly from the conduct at issue in the 2018 matter as it involved ACH payments that were initiated at third party institutions and internal transfers between unaffiliated clients. MSSB reported the incident to the SEC, DOJ and other applicable regulators once it learned of the matter and reached out to compensate all affected clients. Further, MSSB conducted a thorough investigation into the circumstances of FA Rodriguez’s misconduct and, in response to the incident, proactively implemented additional controls relating to RDFI ACHs and enhanced its existing controls around internal “journal” transfers between multiple, unrelated clients to the same MSSB account. In early 2022, MSSB retroactively applied its new RDFI

¹¹ FA Rodriguez misappropriated client funds predominantly by: (i) journaling funds through unrelated client accounts to MSSB accounts affiliated with him and his close family/associates; and (ii) transferring funds directly from client accounts to pay for his own personal expenses via wires and ACH RDFIs.

ACH control and as a result identified and self-reported the misconduct of FAs McKelvey and Chang.

As discussed above, in 2022, MSSB also proactively hired a Consultant to conduct a front-to-back assessment of MSSB's internal fraud and asset movement processes, controls and enhancements. The Consultant concluded that MSSB's existing controls were reasonably designed to ensure the Firm was in compliance with relevant rules and regulations and were consistent with peer institutions. The Consultant proposed certain recommendations to further enhance MSSB's comprehensive control framework, and MSSB has already implemented the vast majority of the recommendations, as discussed above.

MSSB has continued to refine and build upon its policies, procedures and controls for preventing and detecting internal fraud. The Firm respectfully submits that the current matters at issue differ significantly from the 2018 Matter and that its proactive assessment and enhancement of its controls during this period has resulted in the effective detection of incidents of internal fraud.

8. *Provision of Written Description of Administrative Order*

If this requested waiver is granted, until MSSB provides all of the certifications to the Commission staff described above and detailed in the Order, MSSB agrees to furnish (or cause to be furnished) to each purchaser in a Rule 506 offering that would otherwise be subject to the disqualification under Rule 506(d)(1) as a result of the Order, a description in writing of the Order a reasonable time prior to sale.

III. REQUEST FOR WAIVER

In light of the nature of the violations in the Order, the enforcement remedies that already will be obtained by entry of the Order, the remedial measures MSSB has taken and will take, and the fact that the disqualification would have a material and disproportionate negative impact on MSSB's Rule 506 business, MSSB clients and MSSB affiliates, MSSB respectfully submits that it has shown good cause that relief from the Rule 506 disqualification should be granted.

Accordingly, we respectfully urge the Division, on behalf of the Commission, or the Commission, pursuant to Rule 506(d)(2)(ii), to waive the disqualification provisions in Rule 506 under the Securities Act applicable to MSSB and its affiliates as a result of the entry of the Order.

SIDLEY

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We appreciate your consideration of this request. Please feel free to contact me with any questions.

Very truly yours,

A handwritten signature in black ink, appearing to read "Elizabeth A. Marino". The signature is fluid and cursive, with a large initial "E" and "M".

Elizabeth A. Marino