

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

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_____)
In the Matter of:)

Morgan Stanley & Co. LLC,)

Respondent.)
_____)

CFTC Docket No. 12-22

**ORDER INSTITUTING PROCEEDINGS PURSUANT TO
SECTIONS 6(c) AND 6(d) OF THE COMMODITY EXCHANGE ACT, AS AMENDED,
MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS**

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that, from on or about April 18, 2008 through at least October 29, 2009, Morgan Stanley & Co. LLC (“Respondent” or “Morgan Stanley”), acting through its officers, agents or employees, violated Section 4c(a) of the Commodity Exchange Act (the “CEA” or the “Act”), 7 U.S.C. § 6c(a) (2006), as well as Commission Regulations (“Regulations”) 1.38 and 166.3, 17 C.F.R. §§ 1.38 and 166.3 (2011). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Respondent engaged in the violations set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, Respondent has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondent consents to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions (“Order”) and acknowledges service of this Order.¹

¹ Respondent consents to the entry of this Order and to the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party; provided, however, that Respondent does not consent to the use of the Offer, or the findings or conclusions in this Order consented to in the Offer, as the sole basis for any other proceeding brought by the 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 in this Order consented to in the Offer, by any other party in any other proceeding.

III.

The Commission finds the following:

A. Summary

Over an 18 month period, from at least April 18, 2008 through October 29, 2009 (the "Relevant Period"), Morgan Stanley, a Futures Commission Merchant ("FCM") registered with the Commission, acting through its agents, officers and employees, including primarily a senior employee who was both a managing director and branch manager ("Managing Director"), executed, processed and reported numerous off-exchange futures trades to the Chicago Mercantile Exchange ("CME") and Chicago Board of Trade ("CBOT") as exchanges for related positions (hereinafter, "EFRPs"). Those trades, however, were not lawful EFRPs as they lacked the corresponding and related cash, over-the-counter ("OTC") swap, OTC Option, or other OTC derivative (collectively, "cash or OTC derivative") position required to constitute a valid EFRP, pursuant to CME and CBOT rules.

Because the futures trades were executed noncompetitively and not in accordance with the rules governing EFRPs, the trades constituted "fictitious sales" and resulted in non-bona fide prices being reported in violation of Section 4c(a) of the Act and Regulation 1.38(a). In addition, Morgan Stanley's failure to designate the purported trades as EFRPs on all orders, records, and memoranda pertaining thereto constituted a violation of Regulation 1.38(b).

Because Morgan Stanley employees undertook the actions described above within the scope of their employment, Morgan Stanley is liable for their violations of the Act and Regulations pursuant to Section 2(a)(1)(B) of the Act, as amended, and Regulation 1.2.

During the Relevant Period, Morgan Stanley also failed to supervise diligently its employees' handling of the trades at issue, and failed to have adequate policies and procedures designed to detect and deter violations of the Act and Regulations by its officers, employees or agents, such as the off-exchange execution of futures trades improperly designated as EFRPs, in violation of Regulation 166.3.

In accepting Morgan Stanley's Offer, the Commission recognizes Respondent's significant cooperation during the investigation of this matter, including that upon notification of a CME inquiry regarding an EFRP, Morgan Stanley, on its own initiative, immediately launched an internal investigation, identified and reported numerous other trades that were improperly designated as EFRPs, which formed the basis of this action, and took corrective action to address the conduct and improve its supervisory systems and internal controls in order to detect and deter the improper use and mishandling of EFRPs.

B. Respondent

Morgan Stanley is a financial services firm, organized under the laws of Delaware, and is registered as an FCM with the Commission and as a broker-dealer with the Securities and Exchange Commission. Morgan Stanley's principal office is in New York, New York. Among other things, Morgan Stanley executes and clears broker-dealer and customer transactions in commodity futures, stocks, and options in the United States and worldwide.

C. Facts

Morgan Stanley Engaged in Noncompetitive Trading

On numerous occasions throughout the Relevant Period, Morgan Stanley, acting through its employees, including the Managing Director, caused the execution of off-exchange futures trades, primarily in Eurodollar and Treasury Note futures contracts, and improperly designated, processed and reported those trades to the CME or CBOT as EFRPs.

Pursuant to CME Rule 538 and CBOT Rule 538, which are identical in substance, a valid EFRP is a privately negotiated and simultaneous exchange of a futures position for a corresponding and offsetting cash or OTC derivative position. EFRPs must be cleared and reported to the appropriate exchange. Pursuant to Commission Regulation 1.38(b), EFRPs and all related orders, records and memoranda, must be appropriately designated as such.

During the Relevant Period, the Managing Director was a branch manager and interest rate salesman for Morgan Stanley. In order to limit his clients' market risk, the Managing Director caused the execution of off-exchange futures trades. The Managing Director negotiated the futures trades either with Morgan Stanley's U.S. Government Bond Trading Desk or the U.S. Interest Rate Derivatives Trading Desk (collectively, "Government and Swaps Desks"), which are located in Morgan Stanley's New York office. Morgan Stanley acted as the counterparty to the trades with the Managing Director's clients. For all of the trades at issue, the Government and Swaps Desks failed to ensure that there were corresponding and related cash or OTC derivative positions, which are required for EFRPs to be bona fide.

The Managing Director, through his assistants, then caused the trades to be incorrectly designated and reported to the CME or CBOT as EFRPs. The Managing Director accomplished this by transmitting the trade details (including designating the trades as EFRPs) and clearing information to Morgan Stanley's Client Listed Derivatives Operations Department ("Futures Operations"). Futures Operations was responsible for reporting EFRPs to the CME and CBOT. However, this department was not responsible for processing related cash or OTC derivative positions and was not required to confirm that each futures trade was executed with a corresponding cash or OTC derivative position. Morgan Stanley also did not have a supervisory procedure to confirm that futures trades reported to the CME or CBOT as EFRPs were executed simultaneously with a cash or OTC derivative instrument.

Here, nearly all of the EFRPs lacked the required corresponding and related cash or OTC derivative positions.² Accordingly, the trades were not valid EFRPs, but rather were futures trades that were executed off-exchange and noncompetitively. Nonetheless, Morgan Stanley processed and reported those futures trades, including the prices at which they were executed, to the CME and CBOT as valid EFRPs without first ensuring that the trades complied with

² A few of the futures trades had partially offsetting, related cash or OTC derivative components, that were insufficient to satisfy the requirements of CME Rule 538 and CBOT Rule 538.

exchange requirements and had the necessary corresponding cash or OTC derivative components.³

Morgan Stanley Had Inadequate Supervisory Systems and Internal Controls

Morgan Stanley's supervisory systems and internal controls were not adequate to detect and deter the noncompetitive trading of futures contracts improperly designated as EFRPs. Among other deficiencies, Respondent lacked adequate procedures requiring proper documentation of trades executed as EFRPs. For example, the Morgan Stanley Government and Swaps Desks were not required to ensure that for each requested off-exchange futures trade, they also negotiated and documented the corresponding related cash or OTC derivative position. Those desks also were not required to document that the trades were being designated as EFRPs. Similarly, even though Futures Operations had the responsibility to report EFRPs to the CME and CBOT, Futures Operations was not required to verify that the EFRPs had the required corresponding related cash or OTC derivative positions, nor was any other operations department required to do so. In fact, Morgan Stanley had no internal controls or procedures requiring confirmation that futures trades identified as EFRPs were executed simultaneously with a cash or OTC derivative instrument. Thus, Morgan Stanley's procedures and systems did not require adequate documentation and verification of EFRPs, and did not link the futures and related cash or OTC derivative positions of EFRPs. Additionally, Morgan Stanley did not have sufficient surveillance controls to identify trades improperly designated as EFRPs.

Morgan Stanley also failed to ensure that its employees involved in the execution, handling and processing of EFRPs understood the nature of an EFRP and the requirements for executing bona fide EFRPs. This was evidenced by the lack of understanding of EFRPs claimed by various traders and assistants, including senior level traders, during investigative testimony taken by the Commission's Division of Enforcement.

As a result of these supervisory and internal control failures, Morgan Stanley did not detect the noncompetitive execution of the futures contracts and improper designation of futures trades as EFRPs described herein, that occurred over an 18 month period.

IV.

LEGAL DISCUSSION

A. Morgan Stanley's Noncompetitive Trading Violated Section 4c(a) of the Act and Commission Regulation 1.38

Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), makes it unlawful for any person to enter into or confirm the execution of a transaction that is a fictitious sale. "By enacting Section 4c(a), Congress sought to ensure that all trades are focused in the centralized marketplace to

³ Each futures trade must be cleared through a clearing house, and the price of each futures trade must be submitted to the exchange in order to be cleared. See CME Rules 536, 538, and CME Advisory Notice RA1006-5. The CME Advisory Notice provides that "an EFRP may be executed at any commercially reasonable price agreed upon by both parties . . ." Morgan Stanley represents, and the Commission has found no evidence to the contrary, that Morgan Stanley executed the trades at issue at commercially reasonable prices.

participate in the competitive determination of the price of the futures contracts.” *In re Thomas Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194, at 45,742 (CFTC Dec. 10, 1997), quoting S. Rep. No. 93-1131, 93d Cong., 2d Sess. 16-17 (1974); *see also Merrill Lynch Futures, Inc. v. Kelly*, 585 F. Supp. 1245, 1251 n.3 (S.D.N.Y. 1984) (Section 4c(a)(A) was generally intended to prevent collusive trades conducted away from the pits). If a person attempts to evade the risks and price competition of the open market, such trading schemes are generally prohibited as fictitious sales pursuant to Section 4c(a) of the Act. *Id.*

The Commission has long held that illegitimate noncompetitive trading is a form of fictitious sales. *In re Harold Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,982, at 31,903 (CFTC Apr. 4, 1986), *modified* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,401 (CFTC Nov. 26, 1986), *rev'd on other grounds sub nom. Stoller v. CFTC*, 834 F.2d 262 (2d Cir. 1987). “By determining trade information such as price and quantity outside the pit, then using the market mechanism to shield the private nature of the bargain from public scrutiny, both price competition and market risk are eliminated.” *Id.* Trades may constitute fictitious sales even where they do not create the false appearance of having been submitted to the open market. *See In re Thomas Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 45,742 (holding that the transfer of futures contracts among accounts with different ownership through book entries constituted fictitious sales in violation of Section 4c(a) of the Act even though they did not give the false appearance of submitting trades to the open market). In fact, even where there is an exchange for value, the noncompetitive trading of futures contracts, not subject to an exception under exchange rules, constitutes fictitious sales in violation of Section 4c(a) of the Act. *See In re Emil Voytek*, 11 A.D. 778 (1963) (holding that futures contracts traded off-exchange were not valid “changer trades” permitted by the exchange, and therefore constituted noncompetitive fictitious sales in violation of Section 4c of the Act). Thus, Section 4c(a) of the Act broadly prohibits trades intended to avoid the risks and price competition of the open market.⁴

Commission Regulation 1.38(a) allows for certain types of futures trades to be executed noncompetitively, but only if such trades are executed in accordance with the rules of the exchange. Generally, Commission Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2011), requires that all purchases and sales of commodity futures be executed “openly and competitively.” This general requirement, however, “shall not apply to transactions which are executed noncompetitively in accordance with written rules of the contract market . . . specifically providing for the noncompetitive execution of such transactions.” CME Rule 538 and CBOT Rule 538 provide such an exception and allow the noncompetitive execution of EFRPs. If, however, a noncompetitive trade does not qualify for such an exception, it violates Section 4c(a) of the Act and Regulation 1.38(a).

Here, Morgan Stanley, through the acts of the Managing Director and others, knowingly executed numerous noncompetitive futures trades off-exchange which were designated and

⁴ In order to establish a violation of Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), the Commission also must demonstrate that a person knowingly participated in transactions initiated with intent to avoid a bona fide market position. *See In re Harold Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 31,903; *In re Fisher*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,725, at 56,065 (CFTC Mar. 24, 2004).

reported to the CME or CBOT as bona fide EFRPs. However, the trades lacked the corresponding related cash or OTC derivative positions required to constitute bona fide EFRPs. By trading those futures contracts noncompetitively, the Managing Director was able to avoid price competition and market risk. Accordingly, the trades constituted “fictitious sales” and noncompetitive trades, in violation of Section 4c(a) of the Act and Commission Regulation 1.38(a).

Section 4c(a) of the Act also makes it unlawful to offer to enter into, enter into, or confirm the execution of a commodity futures transaction that “is used to cause any price to be reported, registered, or recorded that is not a true and bona fide price.” 7 U.S.C. § 6c(a) (2006). Where a transaction is non-bona fide, in violation of Regulation 1.38(a), the prices reported for such transactions are also non-bona fide. *See In re Gilchrist*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,993, at 37,653 (CFTC Jan. 25, 1991) (finding non-bona fide price in violation of Section 4c(a) of the Act where trades were non-bona fide in violation of Regulation 1.38). In fact, the prices reported on unlawfully executed noncompetitive trades are non-bona fide even if they accurately reflect the prices agreed upon by the parties and the current price for similar contracts traded on exchange. *Id.* In this case, therefore, by executing futures trades noncompetitively, in violation of Section 4c(a) of the Act and Regulation 1.38(a), and reporting those transactions to the CME or CBOT, Morgan Stanley also caused non-bona fide prices to be reported or recorded in violation of Section 4c(a).

Regulation 1.38(b), 17 C.F.R. § 1.38(b) (2011), recognizes that such transactions allowed by exchanges may include the exchange of futures for cash commodities or in connection with cash commodity transactions, but requires such transactions and all orders, records and memoranda pertaining thereto to be designated as such. Morgan Stanley also failed to designate the purported EFRPs on all orders, records, and memoranda pertaining thereto. Accordingly, Morgan Stanley also violated Regulation 1.38(b).

B. Morgan Stanley Failed To Supervise Diligently

Regulation 166.3, 17 C.F.R. § 166.3 (2011), states as follows:

Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

Commission Regulation 166.3 imposes on registrants an affirmative duty to supervise their partners, employees and agents diligently by establishing, implementing and executing adequate supervisory structures 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 appropriate circumstances, a showing that the registrant lacks an adequate supervisory system can be sufficient to establish a breach of duty under Rule 166.3.” See *In re Thomas Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 45,744. A violation under Commission Regulation 166.3 is an independent violation for which no underlying violation is necessary. *Id.*

A violation of Regulation 166.3 is demonstrated by showing either that: (1) the registrant’s supervisory system was generally inadequate; or (2) the registrant failed to perform its supervisory duties diligently. *In re Murlas Commodities*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,485, at 43,161 (CFTC Sept. 1, 1995); *In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360, at 39,219 (CFTC Aug. 11, 1992) (providing that, even if an adequate supervisory system is in place, Regulation 166.3 can still be violated if the supervisory system is not diligently administered); *In re Paragon Futures Assoc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266, at 38,850 (CFTC Apr. 1, 1992) (“The focus of any proceeding to determine whether Rule 166.3 has been violated will be on whether [a] review [has] occurred and, if it did, whether it was diligent”); *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) (noting that, under Regulation 166.3, an FCM has a “duty to develop procedures for the detection and deterrence of possible wrongdoing by its agents”) (internal quotation omitted). Evidence of violations that “should be detected by a diligent system of supervision, either because of the nature of the violations or because the violations have occurred repeatedly,” is probative of a failure to supervise. *In re Paragon Futures Assoc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 38,850.

Here, as found above, Morgan Stanley did not require proper and adequate documentation of EFRPs, including the details of each component transaction, at each stage of the negotiation and processing of the EFRPs. Because Morgan Stanley processes futures transactions separately from cash related commodities, and did not require confirmation that trades designated as EFRPs were executed simultaneously with a cash or OTC derivative instrument, Morgan Stanley lacked adequate internal controls and procedures to verify the validity of EFRPs before they were reported to the CME and CBOT. Morgan Stanley also lacked adequate procedures and surveillance systems to monitor EFRPs and identify trades incorrectly or improperly designated as EFRPs. Furthermore, Morgan Stanley failed to ensure that its employees who participated in the execution or processing of EFRPs had received adequate training regarding EFRPs.

Accordingly, Morgan Stanley failed to supervise diligently, in violation of Commission Regulation 166.3.

C. Morgan Stanley Is Liable for Its Employees’ Acts and Omissions

The foregoing acts, omissions, and failures of Morgan Stanley’s Managing Director and other employees occurred within the scope of their employment, office, or agency with Morgan Stanley; therefore, pursuant to Section 2(a)(1)(B) of the Act, as amended, 7 U.S.C. § 2(a)(1)(B), and Regulation 1.2, 17 C.F.R. § 1.2 (2011), Morgan Stanley is liable for those acts, omissions, and failures in violation of Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), and Commission Regulation 1.38, 17 C.F.R. § 1.38 (2011).

V.

FINDINGS OF VIOLATION

Based on the foregoing, the Commission finds that, during the Relevant Period, Morgan Stanley violated Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), Commission Regulation 1.38, 17 C.F.R. § 1.38 (2011), and Commission Regulation 166.3, 17 C.F.R. § 166.3 (2011).

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 (2011), 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 entry 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 Morgan Stanley violated Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), Commission Regulation 1.38, 17 C.F.R. § 1.38 (2011), and Commission Regulation 166.3, 17 C.F.R. § 166.3 (2011);
 2. orders Morgan Stanley to cease and desist from violating Section 4c(a) of the Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, to be codified at 7 U.S.C. § 6c(a), as well as Commission Regulation 1.38, 17 C.F.R. § 1.38 (2011), and Commission Regulation 166.3, 17 C.F.R. § 166.3 (2011);
 3. orders Morgan Stanley to pay a civil monetary penalty in the amount of Five Million Dollars (\$5,000,000), within ten (10) days of the date of entry of this Order (the "CMP Obligation"). If the CMP Obligation is not paid in full within ten (10) days of the date of entry of this Order, then post-judgment interest shall accrue on the CMP Obligation beginning on the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of this Order pursuant to 28 U.S.C. § 1961 (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 other than by electronic funds transfer, then 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 is to be made by electronic funds transfer, 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 the paying Respondent and the name and docket number of this proceeding. The paying 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, N.W., Washington, D.C. 20581; and

4. orders Morgan Stanley, 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;
- F. Represents that it took the following steps and has made the following changes in light of the facts and events described herein:
1. Morgan Stanley, on its own initiative, dedicated substantial resources to investigate thoroughly the conduct at issue in this Order; to confirm the scope of any improper EFRPs engaged in by the Managing Director, Morgan Stanley conducted a lengthy, manual review of more than two years of electronic communications for the Managing Director and his assistants, identified a substantial number of trades requiring further investigation, and reviewed each of those trades in order to narrow the scope of trades at issue to those that are the subject of this Order; in addition, Morgan Stanley performed a supplemental review of a random sampling of EFRP trades executed with the Interest Rate Desk over one year and did not find any evidence of improper EFRPs, other than those described herein;
 2. Morgan Stanley has developed stronger and additional internal controls and processes to detect and deter the noncompetitive execution of futures trades and the improper designation and reporting of trades as EFRPs to the CME and CBOT, including, but not limited to, requiring new documentation and procedures for verifying CME and CBOT trades as EFRPs, including listing all component parts to such trades, submitting such verification to the Futures Operations department, and requiring operations employees to report the absence of such documentation to their supervisors;
 3. Morgan Stanley has implemented a procedure designed to identify interest rate futures trades improperly reported to the CME and CBOT as EFRPs; the procedure requires a weekly supervisory review of a sampling of the interest rate futures trades reported to the CME and CBOT as EFRPs to confirm that the instructions to Futures Operations identify a cash or OTC derivative transaction in addition to a futures transaction; also on a weekly basis, a subset of the selected EFRPs will be reviewed to confirm that the cash or OTC derivatives portion of the EFRP is sufficiently correlated to the Futures portion of the EFRP to satisfy CME Rule 538 or CBOT Rule 538; the subset of EFRPs that is reviewed for correlation will be a sufficient number to allow Morgan Stanley to reasonably conclude that interest rate trades reported to the CME and CBOT as EFRPs satisfy CME Rule 538 or CBOT Rule 538; any issues will be escalated to risk management and compliance personnel; Morgan Stanley shall retain documentation used in connection with the supervisory review described in this paragraph for a period of 5 years, coextensive with its recordkeeping obligations pursuant to Regulations 1.31 and 1.35;
 4. Morgan Stanley has updated and enhanced its compliance manual and issued related compliance memoranda, notices and bulletins to document its updated and

strengthened procedures for handling EFRPs and to further remind, educate and warn its employees that all futures transactions must be executed through an exchange, unless subject to certain limited exceptions and detailing the requirements of bona fide EFRPs; Morgan Stanley has sent targeted compliance memoranda to the personnel and desks specifically involved in the conduct described herein; and

5. Morgan Stanley has developed, implemented and provided enhanced futures training for all personnel at its trading desks, and since identification of the conduct described herein has offered more than 30 futures training sessions to its employees, at least 11 of which were given either to Futures Operations employees or employees assigned to the Government and Swaps Desks and that were involved in the conduct described herein; Morgan Stanley also has provided additional training to interest rate sales personnel and their assistants; this training will be on-going and shall continue.

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

VII.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

- A. Respondent shall cease and desist from violating Section 4c(a) of the Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, to be codified at 7 U.S.C. § 6c(a), as well as Commission Regulation 1.38, 17 C.F.R. § 1.38 (2011), and Commission Regulation 166.3, 17 C.F.R. § 166.3 (2011).
- B. Respondent shall pay a civil monetary penalty in the amount of Five Million Dollars (\$5,000,000) within ten (10) days of the date of entry of this Order. If the CMP Obligation is not paid in full within ten (10) days of the date of entry of this Order, then post-judgment interest shall accrue on the CMP Obligation beginning on the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of this Order pursuant to 28 U.S.C. § 1961 (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 other than by electronic funds transfer, then 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 is to be made by electronic funds transfer, 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 the paying Respondent and the name and docket number of this proceeding. The paying 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, N.W., Washington, D.C. 20581.

C. Respondent shall comply with the following conditions and undertakings set forth in the Offer:

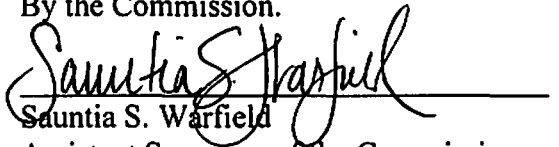
1. **Public Statements:** Respondent agrees that neither it, nor any of its successors and assigns, agents or employees under its authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in this Order or creating, or tending 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.
2. **Future Cooperation with the Commission:** Respondent shall continue to cooperate fully and expeditiously with the Commission, including the Commission's Division of Enforcement, in this proceeding and in any civil or criminal investigation, litigation, or administrative or self-regulatory matter related to the subject matter of this proceeding. As part of such cooperation with the Commission, Respondent agrees to:
 - i. Preserve all records relating to the subject matter of this proceeding, including, but not limited to, audio files, electronic mail, and trading records, for a period of at least three years from the date of this Order or until any related litigation is concluded, including through the appellate review process, whichever period is longer;
 - ii. Comply fully, promptly, completely, and truthfully with any inquiries or requests for information or documents;
 - iii. Provide authentication of documents and other evidentiary material;
 - iv. Produce any current (as of the time of the request) officer, director, employee, or agent of Respondent, regardless of the individual's location and at such location that minimizes Commission travel expenditures, to provide assistance at any trial, proceeding, or Commission investigation

related to the subject matter of this proceeding, including, but not limited to, requests for testimony, depositions and/or interviews, and to encourage them to testify completely and truthfully in any such proceeding, trial, or investigation; and

- v. Assist in locating and contacting any prior (as of the time of the request) officer, director, employee or agent of Respondent.
3. **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.

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

By the Commission.


Sauntia S. Warfield
Assistant Secretary of the Commission
Commodity Futures Trading Commission

Dated: June 5, 2012