

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 64575 / May 31, 2011**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3213 / May 31, 2011**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-14407**

**In the Matter of**

**LARRY FEINBLUM,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTION 203(f) 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 proceedings and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 203(f) of the Investment Advisers Act of 1940 (“Advisers Act”) against Larry Feinblum (“Feinblum” 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 him 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 Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 203(f) 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<sup>1</sup> that:

#### Summary

These proceedings arise out of the fraudulent conduct of Respondent and Jennifer Kim (“Kim”), his direct report, two traders at Morgan Stanley & Co., Inc. (“MS & Co.” or the “firm”), that had the effect of concealing from risk managers the extent of the risk associated with their proprietary trading and that ultimately contributed to millions of dollars of losses in their trading books. From at least October through December 2009, Feinblum and Kim executed numerous trades in certain securities that they traded for MS & Co. that created net risk positions substantially in excess of limits that could be exceeded only with supervisory approval. To conceal from the firm that their trading exceeded internal net risk position limitations (the “excessions”), Feinblum (an Executive Director and Kim’s supervisor) and Kim entered in MS & Co.’s risk management system swap orders -- on at least thirty-two occasions -- that they had no intention of executing and that they promptly canceled after entering the orders in the system. Feinblum and Kim entered those orders for the sole purpose of temporarily and artificially reducing the net risk positions in the securities, as recorded in certain of the firm’s risk management systems, in order to pursue a strategy that sought to profit from price differences between U.S. and foreign markets. Feinblum and Kim cancelled the swap orders after they knew that the risk management systems had captured false and misleading information about their net risk positions and continued to execute their arbitrage trading strategy at positions beyond certain of MS & Co.’s net risk limits. As a result of Feinblum’s and Kim’s misconduct, MS & Co. unwound the unauthorized trading positions, ultimately sustaining a loss of approximately \$24.47 million.

#### Respondent

1. **Feinblum**, age 35, is a resident of New York, N.Y. From May 1999, until his termination effective January 4, 2010, Respondent was associated as a trader with MS & Co., which is dually registered with the Commission as a broker-dealer and as an investment adviser. At termination, Respondent was an Executive Director and a supervisor of the Equity Financing Products Swaps Desk (“Swaps Desk”), where he headed the desk’s principal financing strategy and executed his arbitrage trading strategy. Feinblum was the immediate supervisor of Kim, a trader on the Swaps Desk. During the relevant period, Respondent held Series 3, 7, 24, 55, and 63 licenses.

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<sup>1</sup> The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

## **Relevant Individual and Entity**

2. **Kim**, age 31, is a Canadian citizen who may reside in New York, N.Y., or Canada. Kim was associated with MS & Co. from August 2006, until her termination on January 4, 2010. At termination, Kim was a Financial Associate assigned to the Swaps Desk. Kim reported directly to Feinblum. Kim managed her own trading account as well as the MS & Co. proprietary trading account that Feinblum traded, executing and booking trades and acting as the risk manager for both accounts. During the relevant period, Kim held Series 3, 7, 55, and 63 licenses.

3. **MS & Co.** is a Delaware corporation with its principal place of business in New York, N.Y. It is a wholly-owned subsidiary of Morgan Stanley, the global investment bank. MS & Co. is dually registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and as an investment adviser pursuant to Section 203(a) of the Advisers Act. MS & Co. conducts global equity sales and trading in part, through its Trade Desk. During the relevant period, the Trade Desk facilitated, as principal, emerging market structured product trading with customers. The Trade Desk also entered financing and index arbitrage transactions as principal while sourcing potential inventory for customer or other financing transactions. The Swaps Desk, part of the Trade Desk, conducted customer equity swap trading, principal financing and index arbitrage trading.

## **Background**

### **A. The Swaps Desk**

4. Feinblum began working for MS & Co. in 1999. In 2009, the firm assigned him to head the Swaps Desk's principal financing strategy where he supervised as many as seven other traders, including Kim. As Kim's supervisor, Feinblum trained Kim in the functions of the Swaps Desk in general, and with respect to the arbitrage trading strategy (described below). Feinblum could monitor Kim's trading in real time, as well as the trading of the other traders he supervised.

5. During the relevant period, Respondent supervised or was responsible for trading in over 600 accounts that held, or were authorized to hold, a variety of instruments including, but not limited to, American Depositary Receipts ("ADRs"), equity swaps and Exchange Traded Funds ("ETFs"). Respondent also was responsible for executing an arbitrage trading strategy that sought to profit by shorting ADRs (traded in U.S. markets), while taking a long position in the related common stock (traded overnight in certain Asian markets). The strategy was profitable overall and MS & Co. authorized and supported it.

### **B. Risk Management Processes**

6. As part of its overall risk management system, MS & Co. had risk limits for each trader and for the trading desk where the trader was assigned. During the trading day, MS & Co. electronically monitored on a real time basis the risk positions of each trader's accounts.

Shortly after the close of U.S. markets, MS & Co. required its traders to review and verify an end-of-day summary of the individual trader's positions. After they verified their positions, MS & Co. required traders to certify those positions in the firm's risk system, known as "ER," and the firm essentially took a 'snap shot' of positions as reported and certified. On trade date plus one ("T+1"), ER notified the trader's supervisor if a trader had exceeded the risk limits or that the trader had failed to certify as required.

7. During the relevant period, either Feinblum or Kim verified and certified to ER the positions in the accounts that each traded. As Kim's supervisor, Feinblum had the authority to approve any excessions to desk limits caused by Kim's positions. Similarly, Feinblum, his supervisors, and other members of senior management could approve excessions in Feinblum's accounts. In that regard, Feinblum essentially served a critical control position not only for traders under his supervision but also for his own trading account. Although Feinblum had authority to approve such excessions, it remained incumbent upon him to report his positions in the risk management system accurately to ensure that MS & Co.'s Risk Management Group ("Risk Management") and other supervisors knew of any such excessions.

8. MS & Co. used another control to report and to manage risk on a firm-wide basis. The firm consolidated information from ER and fed that information to a proprietary system that notified Risk Management on T+1 if it detected a risk excession, and identified the specific trade desk, the securities involved, and the related traders whose risk positions contributed materially to the excession. If Risk Management determined the risk unacceptable, it would direct the trader to reduce the risk to appropriate levels. Where appropriate, supervisors could authorize risk excessions and Risk Management could increase the risk limits.

### **C. The Swap Transactions**

9. As part of their trading and hedging strategy, Feinblum and Kim generally traded equity swaps -- synthetic agreements to buy or sell economic exposure (risk) to particular shares. MS & Co. had pre-arranged agreements with a counterparty to take contra-positions pursuant to a "Master Agreement." During the relevant period, Feinblum and Kim executed real swap transactions for two emerging market securities, Wipro Limited ("Wipro") and United Microelectronics Corp. ("UMC") pursuant to the Master Agreement and in two ETF baskets.<sup>2</sup> Feinblum and Kim used the same Master Agreement to enter swap transactions that they intended to cancel almost immediately, which had the effect of tricking MS & Co.'s risk management systems into recording reduced net risk positions, below MS & Co.'s limits. The two traders knew that the system recognized the fake trades as real.

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<sup>2</sup> Wipro is an India-based provider of internet technology services. Its ADRs trade on the NYSE and its common stock trades on the Bombay Stock Exchange and the National Stock Exchange of India. UMC is a global semiconductor manufacturer based in the Republic of China that provides advanced technology and manufacturing services. Its ADRs trade on the NYSE and its common stock trades on the Taiwan Stock Exchange. Both ETFs (MSCI Emerging Markets Index and MSCI South Korea Index) trade on the NYSE.

**D. Execution of Feinblum's Trading Strategy**

10. Feinblum and Kim executed an arbitrage strategy that sought to profit from differences between the prices of ADRs and common stock. Respondent's strategy, specifically, was to sell short ADRs of the two emerging market securities, Wipro and UMC, and hold the common stock long, effectively hedging the two positions against each other. The ADRs in both securities had limited supply available to trade, compared to the number of common shares, and generally the ADRs traded at a significant premium. Respondent believed, however, that this premium would in time collapse due to a number of potential reasons, chief among them that Wipro and UMC eventually would increase the supply of ADRs in U.S. markets. Therefore, Respondent amassed significant short positions in the ADRs, hoping to profit when the price of the ADRs eventually dropped. On the long side of the trade, Respondent believed that with the availability of new ADRs, the price of the common stock, which was low, would increase. Therefore, he maintained a long position in the common stock, expecting to profit from selling the common stock at a higher price. MS & Co. approved of Feinblum's overall strategy with respect to Wipro and UMC.

11. By September 2009, however, Feinblum's and Kim's net risk positions in the proprietary accounts in Wipro, and to a lesser extent UMC, began to increase. Several factors played a part in increasing these net risk positions. First, Respondent continued shorting the ADRs, but did not increase his long position in the related common stock at a sufficient rate, so that his overall risk position in these securities was no longer net flat. Second, the exchange rates (the value of the local currency to the U.S. dollar) were increasing. Third, while the prices of both the ADRs and the common stocks were increasing, the price of the ADRs continued to increase at a rate faster than that of the common stock. As a result of these conditions, the price disparity between the levels of the ADRs and common stock continued to rise, increasing the accounts' net risk positions in each of the two securities and negatively impacting the hedge on these two securities.

**E. Feinblum's Misconduct**

12. On or about September 28, 2009, one of Respondent's supervisors spoke to him about the nature and size of his net risk position in Wipro. At the time that position was U.S. \$20 million. The supervisor told Respondent not to increase the size of the net risk position unless he had significant conviction about the position and had discussed it with the supervisor first. Nevertheless, over the following week, Feinblum and Kim increased the net risk position in Wipro in these accounts. By October 6, 2009, the firm's net aggregate risk position in Wipro had exceeded the limit -- U.S. \$50 million -- that the firm had placed on any single name emerging market security. A member of Risk Management informed Kim that the accounts she and Feinblum traded -- which were aggregated with proprietary positions of other traders in computing the firm's net risk positions -- had caused the firm to breach the U.S. \$50 million net limit with respect to a single-name security, and that they needed to reduce their net risk position in Wipro. Kim notified Feinblum and, as directed, they brought their net risk position in Wipro down so that the firm's aggregate net risk position in Wipro was within the firm's limit.

13. Around the beginning of November, Feinblum's and Kim's net risk position in Wipro increased to U.S. \$30 million (\$10 million more than it was approximately one month earlier). Rather than discussing an increase of the risk limits with his supervisor as Respondent could have done, Respondent, acting with Kim, continued to increase their net risk position in Wipro, but Respondent and Kim devised a deceptive method to make it appear as though they were staying within MS & Co.'s risk limits. Specifically, on thirty-two separate occasions between October and December 2009, Respondent and/or Kim entered swaps with respect to Wipro and/or UMC -- sometimes doing so on consecutive days. Kim booked the swaps expressly to artificially reduce the book's net risk position with respect to Wipro and/or UMC so that it remained under the limit. Kim then falsely verified and certified the position in ER. Minutes later Kim cancelled the swaps, effectively returning the risk level to its true position on the security. Neither Respondent nor Kim requested or filled any orders for these swaps. While engaged in this conduct, Respondent misrepresented to Risk Management that he had reduced his net risk position in Wipro and that his objective was to continue to reduce his net risk position in Wipro as the prices of the ADRs and common stock converged. In fact, however, Respondent and Kim continued to increase the Wipro net risk position.

14. In early December, unrelated to these events, MS & Co. reallocated certain proprietary accounts from Kim to Feinblum. The two traders modified their method of recording trades in the ER in order to artificially reduce the risk across both of their books. Typically, one of the two books held most of the risk, while the other did not. Feinblum and Kim booked a swap between the two books, specifically from the book holding the higher risk position, to the other book, thereby artificially reducing the risk position in the first book. The two traders then published the reduced position for the first book to ER, certified that position, and then minutes later cancelled that swap. The cancellation had the effect of moving the risk back to the first book, where it belonged, and reducing the risk in the second book to its true position. Feinblum and Kim then published the second book's risk to ER and certified the risk position. The two booked the fake swaps only to reduce the books' risk positions in ER.

#### **F. The Misconduct is Exposed**

15. Respondent's and Kim's deceptive entries in the ER system came to light between December 15 and 16, 2009, when the market moved against Feinblum's positions. By close of the market on December 16, Respondent's trade book recorded a significant notional loss. When Respondent left work, he told his supervisor that he had lost \$7 million that day. The next morning, Respondent admitted to the supervisor that he and Kim had exceeded the risk limits repeatedly over the relevant period and had concealed such excessions as described above. Based on his misconduct, MS & Co. terminated Respondent.

16. As a result of the conduct described above, Respondent willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities or security-based swap agreements.

#### IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 203(f) of the Advisers Act it is hereby ORDERED that:

A. Respondent Feinblum cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Feinblum be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, with the right to apply for reentry after two (2) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall pay a civil money penalty in the amount of \$150,000 to the United States Treasury. Payment shall be made in the following installments: \$50,000 within thirty (30) days of the entry of this Order, \$25,000 within ninety (90) days of the entry of this Order, \$25,000 within one-hundred eighty (180) days of the entry of this Order, \$25,000 within two-hundred seventy (270) days, and \$25,000 within three-hundred sixty (360) days of the entry of this Order. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, 100 F Street, N.E., Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Larry Feinblum as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and wire transfer,

money order or check shall be sent to Ken C. Joseph, Assistant Director, Division of Enforcement, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, New York 10281.

By the Commission.

Elizabeth M. Murphy  
Secretary



## Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), on the Respondent and his legal agent.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray  
Chief Administrative Law Judge  
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100 F Street, N.E.  
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