

**COMMONWEALTH OF MASSACHUSETTS
OFFICE OF THE SECRETARY OF THE COMMONWEALTH
SECURITIES DIVISION
ONE ASHBURTON PLACE, ROOM 1701
BOSTON, MASSACHUSETTS 02108**

IN THE MATTER OF:)
)
MORGAN STANLEY SMITH BARNEY LLC,)
)
RESPONDENT.)
_____)

Docket No. E-2016-0055

SECRETARY OF THE COMMONWEALTH
2016 OCT -3 AM 10:06
MORGAN STANLEY SMITH BARNEY LLC

ADMINISTRATIVE COMPLAINT

I. PRELIMINARY STATEMENT

The Enforcement Section of the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth (the “Enforcement Section” and the “Division,” respectively) files this Administrative Complaint (the “Complaint”) to commence an adjudicatory proceeding against Morgan Stanley Smith Barney LLC (“Respondent”) for violations of MASS. GEN. LAWS ch. 110A, the Massachusetts Uniform Securities Act (the “Act”), and the corresponding regulations promulgated thereunder at 950 MASS. CODE REGS. 10.00 – 14.413 (the “Regulations”). The Enforcement Section alleges that Respondent engaged in acts and practices in violation of Section 204 of the Act.

The Enforcement Section seeks an order: 1) finding as fact the allegations set forth below; 2) finding that all the sanctions and remedies detailed herein are in the public interest and necessary for the protection of Massachusetts investors; 3) requiring Respondent to permanently cease and desist from further conduct in violation of the Act and the Regulations; 4) censuring Respondent; 5) imposing an administrative fine on Respondent in such amount and upon such terms and conditions as the Director or Presiding Officer may

determine; 6) requiring Respondent to provide equitable relief to all customers who entered into securities-based loans pursuant to the Sales Contest detailed herein; and 7) taking any such further action which may be necessary or appropriate in the public interest for the protection of Massachusetts investors.

II. SUMMARY

Morgan Stanley's firm-wide culture emphasizes the aggressive cross-selling of banking and lending products to wealth management clients. In 2014 and 2015, this culture inspired at least two sales contests in Massachusetts, which ran undeterred for sixteen months because of Morgan Stanley's lack of adequate compliance and supervisory oversight.

In the wake of the 2008 Financial Crisis, and in response to regulatory changes and trends within the financial services industry, Morgan Stanley placed a greater emphasis on the retail side of its business: wealth management. As a result, the percentage of Morgan Stanley's total revenue derived from wealth management has increased steadily since the Financial Crisis. Despite the growth in its wealth management business, Morgan Stanley trailed its major competitors in one important area: banking and lending. In order to close that gap, Morgan Stanley Financial Advisors, working with Private Bankers, began actively pushing banking and lending products, including Morgan Stanley's Portfolio Loan Accounts ("PLAs"), on clients. PLAs are securities-based loans that allow customers to borrow money against the value of the securities in their investment accounts, with the customer's securities serving as collateral for the loan.

Morgan Stanley's focus on cross-selling banking and lending products to its wealth management clients quickly paid dividends. Morgan Stanley Chairman and Chief Executive Officer James Gorman announced in 2014, "we drove new production records in mortgage and securities-backed lending[.]" These new production records were the result of an aggressive sales approach encouraged and supported by the upper echelon at Morgan Stanley. Changes to Morgan Stanley's Financial Advisor compensation structure reflect this emphasis on banking and lending: Financial Advisors today receive a generous basis point compensation for their banking and lending business, and their sales assistants receive \$50.00 for every processed PLA application.

As part of this emphasis on banking and lending, Morgan Stanley provided Financial Advisors with dozens of triggers for Financial Advisors to use as catalysts to cross-sell PLAs, such as mortgage funding, tax liabilities or obligations, weddings, and graduations. In addition, Morgan Stanley's internal-use materials also offered suggestions on how to overcome client objections to borrowing against their portfolios, including one particularly alarming objection to overcome: "I don't borrow." For clients to whom Morgan Stanley Financial Advisors owe a fiduciary duty, this is not an objection that should be overcome.

In response to cues and pressure from Morgan Stanley, the New England Regional Director (the "Regional Director") and the MetroWest-RI Complex ("MetroWest") Manager (the "Complex Manager") set their sights on increased production in banking and lending. In order to boost banking and lending production, the Complex Manager, along with MetroWest Private Bankers, developed and implemented a sales contest, which encouraged Financial Advisors to push PLAs on clients (the "Sales

Contest”). From the moment it was implemented in January 2014, the Sales Contest ran in violation of Morgan Stanley’s internal Prohibition Against Sales Contests.

MetroWest handpicked the best and brightest Financial Advisors for the Sales Contest. A total of thirty Financial Advisors participated and were located at four Massachusetts branch offices: Springfield, Wellesley, Worcester, and Waltham; and one Rhode Island branch office: Providence. In order to ensure the success of the Sales Contest, the Complex Manager and MetroWest Private Bankers built the Sales Contest on incentives and pressure.

The Complex Manager incentivized participating Financial Advisors to push PLAs on clients by paying them additional business development allowances (“BDAs”). The Sales Contest offered the following payout: \$1,000.00 for 10 loans; \$3,000.00 for 20 loans; and \$5,000.00 for 30 loans. At the direction of the Complex Manager and MetroWest Private Bankers, Financial Advisors, often owing a fiduciary duty to their clients, were now in the business of recommending that their clients burden themselves with debt. Financial Advisors responded to the incentives by nearly tripling their banking and lending production during the Sales Contest. The Sales Contest generated new loan balances totaling nearly \$24,000,000.

The excitement generated by the Sales Contest is on full display in internal e-mails. One participating Financial Advisor asked, “Does the bonus stop at 30 PLA’s? What if we do 60?? Does that double the bonus to our team??? You know how we are about BDA money!!!” Another participating Financial Advisor asked, “Have I or my admin won anything. We have done a ton of pla’s [.]” Another participating Financial Advisor went so far as to say, “Game on.” As these internal e-mails demonstrate, the

incentives paid under the Sales Contest created a material conflict of interest for participating Financial Advisors. However, the Complex Manager never instructed participating Financial Advisors to disclose the additional incentive to their clients – as such, clients opening PLAs were unaware of the Sales Contest’s conflict of interest. Furthermore, the Complex Manager failed to implement any policies or procedures to effectively manage the conflict of interest created by the Sales Contest.

In addition to these incentives, the Complex Manager and MetroWest Private Bankers utilized incessant monitoring and tracking to pressure Financial Advisors to push PLAs on clients. Internal e-mails demonstrate this constant pressure. A MetroWest Private Banker tracked one participating Financial Advisor, stating, “the [client] PLA gets you to 10 deals YTD. A little behind pace to get to 30, but I’m confident we’ll get there.” The Complex Manager informed one Financial Advisor that he was trailing his peers, stating, “Ouch, I know you are competitive [Financial Advisor] so I am sending [the numbers showing Financial Advisor trailing his peers].” In response, the Financial Advisor stated, “I’m pushing. Springfield will be at goal!” MetroWest Private Bankers, in response to pressure from management, sent frequent updates to the Complex Manager. These updates included detailed spreadsheets tracking banking and lending production under the Sales Contest so that the Complex Manager could “see which [Financial Advisors] are doing the business.”

Rather than respond to the needs of their clients, Financial Advisors began to push PLAs in order to win the BDA incentives awarded under the Sales Contest. Financial Advisors used the BDA money awarded to them to wine and dine clients, including the following items: Boston Celtics tickets, client drinks, one client meal in the amount of

\$653.40, and \$1,000.00 in client gifts from one Financial Advisor. By promoting PLAs in order to meet preset goals and earn incentive compensation, the Sales Contest resulted in Financial Advisors acting in their own interest rather than in the best interest of their clients.

Morgan Stanley Compliance and Risk first became aware of the Sales Contest in December 2014, after the Sales Contest had run for nearly a full calendar year. However, no steps were taken to terminate the Sales Contest immediately. In fact, the Complex Manager and MetroWest Private Bankers implemented a new sales contest, which was to run for the calendar year of 2015, prior to receiving instructions to terminate the Sales Contest in 2015. By failing to terminate the Sales Contest immediately, Morgan Stanley knowingly allowed the Sales Contest to continue for months after it was detected. Despite knowledge of the prohibited sales contest running in MetroWest, Morgan Stanley has repeatedly denied the existence of the Sales Contest in statements to the public.

III. JURISDICTION AND AUTHORITY

1. As provided for by the Act, the Division has jurisdiction over matters relating to securities pursuant to chapter 110A of Massachusetts General Laws.
2. The Enforcement Section brings this action pursuant to the authority conferred upon the Division by Sections 407A and 414 of the Act, wherein the Division has the authority to conduct an adjudicatory proceeding to enforce the provisions of the Act.
3. This proceeding is brought in accordance with Section 204 of the Act.
4. The Enforcement Section reserves the right to amend this Complaint and/or bring additional administrative complaints to reflect information developed during the current and ongoing investigation.

IV. RELEVANT TIME PERIOD

5. Except as otherwise expressly stated, the conduct described herein occurred during the approximate time period of September 1, 2013 to August 20, 2015 (the “Relevant Time Period”).

V. RESPONDENT

6. Morgan Stanley Smith Barney LLC (hereinafter “Morgan Stanley”) is a Delaware limited liability company with a principal place of business located at 2000 Westchester Avenue, Purchase, New York 10577-2530. According to the Delaware Division of Corporations, Morgan Stanley first incorporated on February 2, 2009. Morgan Stanley has a Financial Industry Regulatory Authority (“FINRA”) Central Registration Depository (“CRD”) number of 149777. Morgan Stanley has been registered as a broker-dealer in the Commonwealth of Massachusetts since May 22, 2009.

VI. STATEMENT OF FACTS

A. Morgan Stanley’s Firm-Wide Culture Emphasized the Cross-Selling of Banking & Lending Products

7. In the wake of the 2008 Financial Crisis, Morgan Stanley placed a greater emphasis on the retail side of its business: wealth management.

8. As part of this emphasis, Morgan Stanley sought to bring its wealth management clients into its affiliated banking business at Morgan Stanley Private Bank (“MSPB”).

9. Morgan Stanley enters into arrangements with MSPB to assist in offering certain banking and lending related products and services.

10. MSPB lends money to Morgan Stanley’s brokerage and advisory clients.

11. Morgan Stanley’s business model emphasized the sale of MSPB products and services to Morgan Stanley customers, including Massachusetts residents.

12. Morgan Stanley placed particular emphasis on securities-based lending, including its securities-based loans, known as Portfolio Loan Accounts (“PLAs”).

13. PLAs allow Morgan Stanley customers to borrow money against the value of the securities in their investment accounts, with the customer’s securities serving as collateral for the loan.

14. Morgan Stanley’s banking and lending focus quickly paid dividends – in 2014, Morgan Stanley Chairman and Chief Executive Officer James Gorman stated, “We drove new production records in mortgage and securities-backed lending[.]”

15. In 2013, 9% of Morgan Stanley’s Wealth Management clients had a securities-based loan at Morgan Stanley.

16. In 2014, 12% of Morgan Stanley’s Wealth Management clients had a securities-based loan at Morgan Stanley.

17. In the third quarter of 2015, 15% of Morgan Stanley’s Wealth Management clients had a securities-based loan at Morgan Stanley.

18. The Enforcement Section first became aware of Morgan Stanley’s securities-based lending push in 2015, when a former Morgan Stanley Financial Advisor responded to a Division inquiry concerning his departure from Morgan Stanley.

19. The former Morgan Stanley Financial Advisor stated, in relevant part:

Morgan Stanley told our office during the end of February [2015] and beginning of March to pitch this product [PLAs] to all its customers. Management said they were doing this to keep up with its major competitor, Merrill Lynch, who was already offering express credit lines. They told us that there was big money to be made by having our customers take out credit since the variable interest rate was profitable to the company and they could just sell out of the customers positions if the customer failed to make the payment. They told us to call our customers to tell them that they could use the credit line to buy a house, pay for a home improvement project, buy a car and/or pay for school, etc. **They asked us**

regularly how many people we had put in these products and used measurement tools to compare us amongst our peers. I did not feel comfortable recommending every customer establish a credit line because I felt that my role as a Financial Advisor and Fiduciary was to help customers save and make money and not go into bad debt.

(Emphasis added.)

a. Morgan Stanley Developed the “System” and Internal-Use Materials to Push Banking & Lending Products on Clients

20. Morgan Stanley Financial Advisors (“Financial Advisors” or “FAs”) are responsible for managing Morgan Stanley client relationships.

21. Morgan Stanley hired Private Bankers to work with Financial Advisors to introduce securities-based lending capability to clients.

22. In an effort to boost banking and lending production, Morgan Stanley Private Bankers developed and employed the “System,” which aimed to introduce securities-based lending to the entire client base of assigned Financial Advisors.

23. One Private Banker in Morgan Stanley’s MetroWest-RI Complex (“MetroWest”) described the “System” as a process-based sales approach vs. a need-based approach to securities-based lending.

24. Under the “System,” Morgan Stanley sales assistants inserted securities-based lending materials with account opening paperwork to ensure the introduction of securities-based lending capability and prompt client response during every new account opening.

25. Morgan Stanley marketed PLAs to its clients as a way to “Unlock the Value of Your Portfolio.”

26. Morgan Stanley’s internal-use materials recommended that Financial Advisors look for specific triggers as catalysts to offer clients securities-based lending products.

27. These triggers included “bridge loans for mortgage funding,” “tax liabilities or obligations,” “weddings, graduations, etc.,” and frivolous spending in the form of “purchasing a luxury item like a car or yacht.”

28. Internal-use materials instructed Financial Advisors on how to overcome certain client objections to securities-based lending, including the objection, “**I don’t borrow.**” (Emphasis added.)

29. Morgan Stanley’s internal-use materials instructed Financial Advisors to encourage their clients to open a line of credit even if the client did not intend to draw on it.

30. One internal document used by MetroWest Private Bankers quoted the movie *Field of Dreams*, “If you build it, they will [come],” thus illustrating that Morgan Stanley clients increasingly utilized their Morgan Stanley lines of credit the longer they remained open.

31. For example, this internal document illustrates that 25% of Morgan Stanley clients utilized their securities-based loan within a month of its opening, while 37% of Morgan Stanley clients utilized their securities-based loan within eighteen months of its opening.

32. Internal-use materials highlighted the benefits of securities-based lending, but downplayed the risks, which were included in the fine print and only partially disclosed.

33. The risks associated with securities-based loans are material.

34. For example, in the event that the value of a client’s securities pledged as collateral decline significantly, Morgan Stanley may liquidate those securities if the client is unable to post additional collateral.

35. If a client is unable to repay the balance of their PLA, Morgan Stanley may liquidate securities without first notifying the client.

36. If a client prepays the balance of their PLA, Morgan Stanley may charge the client a prepayment penalty.

37. PLAs make it more difficult for clients to move their assets to a new firm if those assets are pledged as collateral at Morgan Stanley because the client is required to pay off any PLA balance prior to transferring their assets.

b. Morgan Stanley Compensated and Incentivized Financial Advisors to Cross-Sell

38. Morgan Stanley changed its Financial Advisor Compensation Plan to promote the sale of Morgan Stanley proprietary products, including securities-based lending products.

39. According to the Banking & Lending Award Grid of Morgan Stanley's 2014 Financial Advisor Compensation Plan, Financial Advisors received a net award between 35 and 50 basis points of their banking and lending growth.

40. At all times during the Relevant Time Period, Morgan Stanley sales assistants received \$50.00 for each processed PLA application, referred to internally as a "\$50 Branch Support Staff Administrative Incentive."

41. The MetroWest Complex Manager (the "Complex Manager") received twenty-five basis points on the profitability of the overall business in MetroWest on a quarterly basis.

B. Morgan Stanley's MetroWest Complex Created a Sales Contest in Response to Firm-Wide Cross-Selling Emphasis

a. Structure of Sales Contest

42. To incentivize Financial Advisors to offer securities-based lending products to clients, the Complex Manager developed a sales contest, referred to internally as a business development pilot program, for thirty MetroWest Financial Advisors in late 2013 (the "Sales Contest").

43. The Sales Contest set sales goals and established an incentive structure that promoted the sale of MSPB products to Morgan Stanley customers by Financial Advisors and Private Bankers.

44. The Financial Advisors participating in the Sales Contest were located at five Morgan Stanley branch offices: Springfield, Massachusetts; Waltham, Massachusetts; Wellesley, Massachusetts; Worcester, Massachusetts; and Providence, Rhode Island.

45. The Complex Manager oversaw all of the Morgan Stanley branches and employees involved in the Sales Contest.

46. The Associate MetroWest Complex Manager and three MetroWest Private Bankers assisted in the development and implementation of the Sales Contest.

47. The Complex Manager, with the assistance of the MetroWest Private Bankers, implemented the Sales Contest in the first quarter of 2014.

48. In addition to their role as Private Bankers, all of the MetroWest Private Bankers were registered as Morgan Stanley broker-dealer agents in Massachusetts.

49. The Sales Contest covered banking and lending products, including PLAs, mortgages, and tailored loans.

50. The Sales Contest incentivized the sale of these products by offering Financial Advisors additional business development allowances (“BDAs”).

51. Financial Advisors receive BDAs at the beginning of each year for business development purposes.

52. According to Morgan Stanley’s 2014 Financial Advisor Compensation Plan, Financial Advisors earned between \$250.00 and \$25,000.00 in BDAs depending on their gross revenue from the prior year.

53. The Sales Contest paid additional BDAs to participating Financial Advisors for meeting preset banking and lending production thresholds.

54. Financial Advisors participating in the Sales Contest earned \$1,000.00 after initiating ten lending relationships, \$3,000.00 for twenty lending relationships, and \$5,000.00 for thirty lending relationships.

55. The \$5,000.00 available under the Sales Contest represented a substantial and material amount of BDAs for Financial Advisors participating in the Sales Contest.

56. For example, a Morgan Stanley Financial Advisor whose gross revenue for the prior year falls between \$2,500,000.00 and \$5,000,000.00 earns \$15,000.00 in BDAs; the \$5,000.00 available under the Sales Contest would lead to an increase of over 33%.

57. On February 25, 2014, MetroWest held a kick-off webinar for the Sales Contest (“Sales Contest Kick-Off”) and congratulated participating Financial Advisors via e-mail on being selected for the Sales Contest.

58. The Sales Contest Kick-Off informed participating Financial Advisors of the resources available to them during the Sales Contest, including, “Access to resources for planning/funding client events,” “Access to specialized training and resources,”

“Dedicated access” to Private Banking Advisory Associates, “Priority Access” to Private Bankers, and “BDA incentive[.]”

59. As part of the Sales Contest Kick-Off, MetroWest Private Bankers instructed Financial Advisors to draft a list of their clients to be offered securities-based loans.

60. MetroWest also made available to participating Financial Advisors copies of a book, titled “The Value of Debt,” by Morgan Stanley Financial Advisor Thomas Anderson.

61. MetroWest encouraged Financial Advisors to read “The Value of Debt,” which suggests that debt can be good for senior citizen clients.

b. Morgan Stanley Management had Knowledge of the Sales Contest

62. Internal e-mails show that the New England Regional Director (the “Regional Director”) had knowledge of the Sales Contest as early as January 28, 2014, when the New England Business Development Officer informed the Regional Director of the Sales Contest via e-mail.

63. The Regional Director responded, “Nice recap. How do you recommend we reiterate/reinforce?”

64. Additional internal e-mails demonstrate the Regional Director’s knowledge and approval of the Sales Contest.

65. In a March 27, 2014 e-mail, one MetroWest Private Banker stated:

B&L [banking and lending] for BDA Pilot: Created in conjunction with [Complex Manager] and [Business Development Manager]. Each banker identified 3 high opportunity FAs. To incent FAs to do the business [Complex Manager] has agreed to give them additional BDA for hitting unit goals. [Regional Director] ok’d during our [Quarterly Business Review.]

(Emphasis added.)

66. The Regional Director testified that if a prohibited sales contest existed within his area of responsibility, it would be his responsibility to shut down that sales contest.

67. However, the Regional Director did not take any steps to terminate the Sales Contest immediately.

68. The Head of National Sales for MSPB (“HNS”) had knowledge of the Sales Contest as early as May 9, 2014.

69. In response to an e-mail asking HNS to participate in a call to pitch the “System” to Sales Contest Financial Advisors, HNS responded, “Wow. Big commitment by the region. I’ll absolutely do it.”

70. HNS did not take any steps to terminate the Sales Contest immediately.

c. The Sales Contest Created a Material Conflict of Interest through Financial Advisor Incentives

71. The Complex Manager built the Sales Contest on financial incentives and pressure.

72. The Complex Manager utilized BDA as an incentive to ensure the success of the Sales Contest.

73. Participating Financial Advisors were excited about and responded to the BDA incentive offered under the Sales Contest.

74. In a February 25, 2014 e-mail sent immediately following the Sales Contest Kick-Off, one Financial Advisor asked, “Does the bonus stop at 30 PLA’s? What if we do 60?? Does that double the bonus to our team??? **You know how we are about BDA money!!!**” (Emphasis added.)

75. In a January 30, 2014 e-mail, one MetroWest Private Banker, while referring to the additional BDA as a “bonus,” stated, “Let’s do our best to max this out. I want to make a big splash here to encourage [Complex Manager] to continue these initiatives.”

76. Sales assistants within MetroWest also benefited from the banking and lending business generated by the Sales Contest.

77. In a March 12, 2014 e-mail, one MetroWest Private Banker informed Sales Contest participants, “[sales assistants] can now earn unlimited compensation for PLAs.”

78. The Private Banker further stated, “I’d love to see you receive the max BDA award while getting [sales assistant] \$1500+ in comp from the bank!”

79. In a March 11, 2014 e-mail, sent two weeks after the Sales Contest Kick-Off, one participating Financial Advisor asked, “Have I or my admin won anything[?]. We have done a ton of pla’s [.]”

80. The Financial Advisor was looking for his \$1,000.00 in BDA “to do some entertaining.”

81. Financial Advisors used approximately 97% of the BDAs awarded under the Sales Contest to entertain clients, including such items as Boston Celtics tickets, client drinks, client gifts, and client meals.

82. Morgan Stanley, MetroWest, and participating Financial Advisors failed to disclose the BDA incentive to clients.

d. Morgan Stanley Created a Culture of Competition, Pressured Financial Advisors to Cross-Sell, and Closely Tracked Results

83. In addition to the BDA incentive, the Sales Contest involved a high degree of pressure as the Complex Manager and MetroWest Private Bankers monitored and tracked the banking and lending business of participating Financial Advisors and Private Bankers.

84. MetroWest Private Bankers reviewed their assigned Financial Advisors' books of business in order to target high opportunity clients for securities-based loans.

85. One MetroWest Private Banker communicated such a review to a participating Financial Advisor in a March 5, 2014 e-mail, stating: "Per our meeting last week please find attached a complete PLA book review for all you [sic] clients. You have approximately 115 existing PLA opportunities within your book, so there is no reason we shouldn't be able to **knock this out of the park** and get you over the 30 unit count[.]" (Emphasis added.)

86. The Complex Manager received frequent updates from MetroWest Private Bankers on the banking and lending business generated under the Sales Contest.

87. On March 5, 2014, one MetroWest Private Banker sent the Complex Manager an update on one participating Financial Advisor, stating, "[Financial Advisor] has committed to me that we will reach 30 units this year. If we can get him to accomplish it will go a long way to driving the rest of Fas in Worcester to get on board."

88. In response, the Complex Manager stated, "Agreed, keep me posted regularly on this thx [.]"

89. On April 3, 2014, one MetroWest Private Banker sent an update on one participating Financial Advisor via e-mail, stating, "he went from 0 [banking and

lending] deals in 3+ years to 4 PLAs booked in Q1,” which was the first quarter in which the Sales Contest ran.

90. The Private Banker further stated that he was taking steps to “ensure we are giving [Financial Advisors] every opportunity to move the needle.”

91. The Complex Manager applied additional pressure in a September 30, 2014 e-mail, asking, “Any thoughts on sending out the ranking to all pilot [FAs]?”

92. The Complex Manager added to the competitive environment fostered by the Sales Contest.

93. When one Springfield-based Financial Advisor participating in the Sales Contest was trailing his peers in banking and lending business, the Complex Manager stated in a May 9, 2014 e-mail, “Ouch, I know you are competitive [FA] so I am sending [the numbers showing FA trailing his peers].”

94. The Financial Advisor responded, “I’m pushing. Springfield will be at goal!”

95. The same Springfield-based Financial Advisor followed up with his team in an August 27, 2014 e-mail, stating, “More PLA’s = more \$\$ in our BDA account. This is very easy to do. [Sales Assistant] is good processing them. Let’s try and finish the year strong!”

96. One MetroWest Private Banker sent another update to a participating Financial Advisor in a May 30, 2014 e-mail, stating, “The [client] PLA gets you to 10 deals YTD. A little behind pace to get to 30, but I’m confident we’ll get there.”

97. The Financial Advisor responded, “Game on.”

98. The Complex Manager also tracked the production of MetroWest Private Bankers under the Sales Contest.

99. In a May 8, 2014 e-mail, one MetroWest Private Banker sent a quarterly update of the Sales Contest to the Complex Manager, which showed one Private Banker trailing others.

100. After one MetroWest Private Banker expressed frustration to a fellow Private Banker via e-mail, that Private Banker responded, “You know...that pisses me off for you. The only reason he [MetroWest Private Banker] sent that is bc he is at the top.”

101. Under the Sales Contest, MetroWest Private Bankers were similarly focused on their banking and lending numbers, not on the needs of Morgan Stanley clients.

e. The Sales Contest Nearly Tripled the MetroWest Complex’s Banking & Lending Business

102. The Sales Contest proved successful for MetroWest, the Complex Manager, and Morgan Stanley, as indicated by one Private Banker’s December 3, 2014 e-mail, which included the following table:

Team	2013 Units	2014 Units	Year/Year change	New Balances
Team 1	6	24	400%	\$1,094,458.00
Team 2	10	22	220%	\$3,127,864.00
Team 3	23	21	91%	\$8,884,563.00
Team 4	4	19	475%	\$866,330.00
Team 5	4	18	450%	\$4,143,806.00
Team 6	2	14	700%	\$536,375.00
Team 7	3	12	400%	\$2,236,537.00
Team 8	3	11	367%	\$1,380,836.00
Team 9	0	11		\$1,097,916.00

Team 10	5	6	120%	\$353,697.00
Team 11	0	5		\$162,304.00
Totals	60	163	272%	\$23,884,686.00

103. According to the Private Banker’s December 3, 2014 e-mail, Financial Advisors participating in the Sales Contest nearly tripled their banking and lending production from 2013 to 2014, and one participating team increased their banking and lending production by 700% over the same time period.

104. In response to a September 30, 2014 update from the Complex Manager regarding the Sales Contest, the Regional Director stated, “Impressive [.]”

105. The Sales Contest generated new loan balances totaling nearly \$24,000,000.00.

106. In a December 2, 2014 e-mail regarding the Sales Contest, the Complex Manager stated, “Phenomenal. Assuming a profit of 150 [basis points] on the 24mm--we have 360k in new revenue minus the BDA \$ (1 time) and FA comp. very very profitable [.]”

C. Morgan Stanley Failed to Reasonably Supervise its Agents in Connection with the Sales Contest

a. Morgan Stanley’s Prohibition Against Sales Contests

107. Morgan Stanley has an internal policy titled “Prohibition Against Sales Contest,” (“Prohibition”) which was in effect during the entirety of the Sales Contest.

108. The Prohibition “completely prohibits participation in sales contests, unless the contest under consideration is a national sales contest.”

109. The Sales Contest was a Complex sales contest, not a national sales contest.

110. In a March 12, 2014 e-mail to participating Financial Advisors, one MetroWest Private Banker, while referring to the BDA incentive as a "\$1k award," stated, "This is a complex vs a firm initiative so we're defining the rules as we go along here..."

111. The Prohibition states, "National sales contests may be eligible for a **limited** exemption with prior written approval by the Head of U.S. Wealth Management [.]"
(Emphasis in original.)

112. The Sales Contest received no prior written approval.

113. The Prohibition defines a "sales contest" as "an arrangement that offers associated persons or their supervisors additional compensation in the form of bonus payments, incentives, or non-cash compensation to promote the sale or achievement of a specified level of sales over a specified period of time."

114. The Sales Contest offered additional incentives in the form of BDAs, preconditioned on the sale of specified levels of banking and lending products over the course of 2014.

115. The Prohibition does not permit "product-specific sales contest[s]," which "refers to sales contests designed to promote the sale of specific categories of products[.]"

116. The Sales Contest was specific to banking and lending products, and promoted PLAs in particular.

117. The Prohibition further prohibits sales contests "having an impact on an FA's independent judgment in providing financial services and advice to his or her clients or could give rise to, or create an appearance of, a conflict of interest with clients."

118. Under the Sales Contest, Financial Advisors could receive a substantial and material increase in their BDA funds.

119. The Sales Contest could impact a Financial Advisor's independent judgment, thereby creating a conflict of interest.

b. Compliance and Risk Discovered the Sales Contest

120. The Sales Contest ran undetected by Compliance and Risk in MetroWest for nearly the full calendar year of 2014.

121. On December 3, 2014, more than eleven months into the Sales Contest, one MetroWest Private Banker touted the success of the Sales Contest in an e-mail to other private bankers within New England, stating:

YTD we've paid out \$15,000 in extra BDA incentive, but will probably end the year at about \$23,000 paid out. So, **in theory**, the one-time \$23k BDA investment should produce \$515k in annual revenue.

(Emphasis in original.)

122. The December 3, 2014 e-mail prompted one or more private bankers, including some within New England, to consider implementing similar programs within their Complexes.

123. Based on this December 3, 2014 e-mail, one Greater Pittsburgh Complex Private Banker ("Pittsburgh PB") sought the approval of his Senior Complex Risk Officer ("SCRO") prior to implementing a similar sales contest.

124. Pittsburgh PB's December 14, 2014 e-mail to SCRO reads, in relevant part:

Hi [SCRO] – Remember about a year and a half ago we ran a campaign in the complex where each new PLA opened translated to \$50 in BDA ? I think it was during the summer of 2013 for two months? We are about to run something similar with the following criteria : \$ 500 in BDA for 10 new PLA's (per team or person) [,] \$1,500 in BDA for 20 new PLA's (per team or person) [.] From a risk perspective, is there any reason that we couldn't do this or any concerns you can think of?

125. The next morning, SCRO began the process of consulting with individuals in Compliance and Risk, including the Associate Regional Risk Officer for New England (“ARRO”) and an Associate Business Service Manager, who stated, “This does not sound right to me. Seems like a sales contest. Would need to run by Compliance.”

126. SCRO then followed up with Pittsburgh PB, stating, “No, Joe. We can’t do that. **That would be considered a sales contest.**” (Emphasis added.)

127. After receiving some pushback, SCRO followed up with Pittsburgh PB again, stating, “[Pittsburgh PB], I can’t support this. I agree with you that it looks like it worked beautifully for Metro West, but at the same time, it resembles too closely to a sales contest (I fail to see how it doesn’t meet the description of a sales contest) [.]”

128. New England Regional Compliance Officer (“RCO”) relayed the same message via e-mail on December 15, 2014 and also received some pushback, “I called and said no – it is a contest but they are saying others are doing it and it is not a contest b/c everyone is a winner.”

129. After reviewing the situation, RCO informed ARRO and SCRO of the Compliance determination in a December 15, 2014 e-mail, which reads, in relevant part, “I also reviewed this with other folks who agreed [] – **this would be a sales contest and should not be allowed unless done nationally.** [ARRO] – I would advise all to have conversations with their branches, letting them know these types of contest (incentives) should not be happening.” (Emphasis added.)

130. After receiving the Compliance determination, ARRO followed up with her boss, the New England Regional Risk Officer (“RRO”), via e-mail on December 15, 2014.

131. ARRO's December 15, 2014 e-mail to RRO included a draft e-mail to inform those Complexes interested in implementing similar programs that such contests and incentives are not permitted at Morgan Stanley:

Good Afternoon – With banking and lending being a major focus of the firm, we understand that you and your teams are trying to be creative in gaining participation in the different programs. Recently, we've learned of a few complexes who are offering extra BDA incentives upon FA's [sic] opening a certain number of PLAs. **After a review with our friends in Compliance, this is unfortunately viewed as a contest and is not permitted.**

(Emphasis added.)

c. Morgan Stanley Failed to Terminate the Sales Contest Immediately

132. ARRO's draft e-mail was never sent, however, because, as RRO testified, "We discussed it, [ARRO] and I, and decided that it would be better for us to talk about it verbally as opposed to putting it out in an E mail format."

133. RRO took no steps to terminate the Sales Contest immediately.

134. RRO testified that she waited approximately four weeks before discussing the Sales Contest with the Regional Director.

135. During this time, MetroWest had implemented a new sales contest, which was to run for the calendar year of 2015.

136. After discussing the Sales Contest with the Regional Director, RRO testified that she verbally instructed the Complex Manager to terminate the Sales Contest in January 2015, approximately four weeks after RRO became aware of the Sales Contest's existence.

137. RRO testified to the Division that she did not follow up with the Complex Manager after their January 2015 call because, “I had asked him to stop, and I – I – usually when I ask the complex managers to do something it’s done.”

138. RRO also testified that she did not follow up to confirm that the Complex Manager terminated the Sales Contest because, “I assumed it was. I can’t tell you for certain that it was.”

139. RRO further testified that it was her expectation, after instructing the Complex Manager to terminate the Sales Contest, that it would be done, “pretty quickly – within a month.”

140. However, the Sales Contest continued in MetroWest until at least the first quarter of 2015.

141. The Complex Manager testified to the Division that the Regional Director instructed him to terminate the Sales Contest for the first time in April 2015.

142. Morgan Stanley knowingly allowed the Sales Contest to continue for at least four months after it was discovered and deemed impermissible by Compliance and Risk.

D. Morgan Stanley Disseminated Statements Denying the Existence of the Sales Contest

143. In contrast to Morgan Stanley’s in-house Compliance determination that the Sales Contest was in fact a prohibited sales contest, Morgan Stanley’s public statements repeatedly denied that a prohibited sales contest ran in MetroWest.

144. In a March 2, 2016 article published by the *New York Post*, a Morgan Stanley corporate communications spokeswoman stated, in reference to the Sales Contest, “It would be inaccurate to refer to this as a sales contest.”

145. In a March 3, 2016 article published by *AdvisorHub*, the same spokeswoman stated, in reference to the Sales Contest, “This was not a sales contest and was extremely limited.”

146. Upon information and belief, programs similar to the Sales Contest have run in other Morgan Stanley Complexes.

VII. VIOLATIONS OF LAW

Count I – Violation of MASS. GEN. LAWS ch. 110A, § 204(a)(2)(G)

147. Section 204(a)(2)(G) of the Act provides:

(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:-

(G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business [.]

MASS. GEN. LAWS ch. 110A, § 204(a)(2)(G).

148. The Enforcement Section herein re-alleges and re-states the allegations of fact set forth in Section VI above.

149. The conduct of Respondent, as described above, constitutes violations of MASS. GEN. LAWS ch. 110A, § 204(a)(2)(G).

Count II – Violation of MASS. GEN. LAWS ch. 110A, § 204(a)(2)(J)

150. Section 204(a)(2)(J) of the Act provides:

The secretary may by order deny, suspend, or revoke any registration if he finds (1) that the order is in the public interest and (2) that the applicant or registrant

(J) has failed reasonably to supervise agents, investment adviser representatives or other employees to assure compliance with this chapter [.]

MASS. GEN. LAWS ch. 110A, § 204(a)(2)(J).

151. The Enforcement Section herein re-alleges and re-states the allegations of fact set forth in Section VI above.

152. The conduct of Respondent, as described above, constitutes violations of MASS. GEN. LAWS ch. 110A, § 204(a)(2)(J).

VIII. STATUTORY BASIS FOR RELIEF

Section 407A of the Act provides, in pertinent part:

(a) If the secretary determines, after notice and opportunity for hearing, that any person has engaged in or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule or order issued thereunder, he may order such person to cease and desist from such unlawful act or practice and may take such affirmative action, including the imposition of an administrative fine, the issuance of an order for an accounting, disgorgement or rescission or any other such relief as in his judgment may be necessary to carry out the purposes of [the Act].

MASS. GEN. LAWS ch. 110A, § 407A.

IX. PUBLIC INTEREST

For any and all of the reasons set forth above, it is in the public interest and will protect Massachusetts investors for the Director to enter an order finding that such “action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes fairly intended by the policy and provisions of this chapter [MASS. GEN. LAWS ch. 110A].”


X. RELIEF REQUESTED

The Enforcement Section of the Division requests that an order be entered:

- A. Finding as fact all allegations set forth in Section VI of the Complaint;
- B. Finding that all the sanctions and remedies detailed herein are in the public interest and necessary for the protection of Massachusetts investors;
- C. Requiring Respondent to permanently cease and desist from further conduct in violation of the Act and the Regulations in the Commonwealth;
- D. Censuring Respondent;
- E. Imposing an administrative fine on Respondent in an amount and upon such terms and conditions as the Director or Presiding Officer may determine;
- F. Requiring Respondent to provide equitable relief to all customers who entered into securities-based loans pursuant to the Sales Contest; and
- G. Taking any such further action which may be in the public interest and necessary and appropriate for the protection of Massachusetts investors.

**MASSACHUSETTS SECURITIES DIVISION
ENFORCEMENT SECTION**

By and through its attorneys,



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Dated: October 3, 2016