




August 2, 2007

DOW JONES REPRINTS

 This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit: www.djreprints.com.

- [See a sample reprint in PDF format.](#)
- [Order a reprint of this article now.](#)

Morgan Stanley Faces Fine

Firm Likely to Pay \$6.1 Million in Case Tied to Bond Sales

By **RANDALL SMITH**

August 2, 2007; Page C3

Securities regulators plan to penalize **Morgan Stanley** \$6.1 million for allegedly overcharging customers on \$59 million in bond sales, in a case that shows how easily unwary investors can overpay for such securities.

The Wall Street firm allegedly overcharged customers of its retail brokerage unit in more than 2,800 separate bond sales from the firm's own inventory, according to people familiar with the case. The New York firm, which is expected to settle the charges without admitting or denying wrongdoing, declined to comment yesterday.

The Financial Industry Regulatory Authority, the combined broker-regulation and enforcement organization for Wall Street, plans to fine the blue-chip securities firm \$1.5 million and order \$4.6 million in restitution to customers who paid markups as high as 18% in 2001 for surplus notes issued by Kemper Lumbermens Mutual Casualty Co., the people said. The announcement is expected today.

The case shows how difficult it can be for individual investors to know what price they should be paying for individual bonds -- unlike stocks or mutual funds whose current market prices are widely disseminated.

"When someone buys the stock of IBM, there's a transparent past about what others have paid that's missing in the corporate-bond market," said Elizabeth Warren, a professor of contracts and commercial law at Harvard Law School.

Although securities regulations generally limit the amount of profit or markup a brokerage firm can receive on securities sales at 5%, Morgan Stanley sold the bonds in the first half of 2001 at prices 4% to 18% higher than the firm itself had paid.



Charging Too Much?

Regulators allege that Morgan Stanley violated rules when "marking up" bonds for a profit. A markup above 5% can violate guidelines. The firm is expected to settle the charges without admitting or denying wrongdoing. An example of the alleged activity:

- Morgan Stanley sold certain corporate bonds (Kemper Lumbermens Mutual Casualty Co. 9.15% notes) to small investors at prices ranging from \$98.50 to \$103.
- At the same time, Morgan Stanley's own trading positions in these bonds had a cost basis ranging from \$88.22 to \$93.23.
- That means the markups of the price that investors paid, over Morgan's cost, ranged from 6.19% to 16.18%.
- Total markups were \$4.1 million on the sale of these notes
- A total 1,633 transactions had markups over 5%, most of them over 10%. Markups generally should not exceed 5% under industry guidelines, and sometimes should be lower.

Source: WSJ research

Finra plans to levy a fine of \$40,000 against Kenneth S. Carberry III, the firm's corporate-bond trader in New York responsible for setting the excessive prices. He will be suspended for 15 days under an agreement between Finra and the firm. Morgan Stanley said Mr. Carberry was unavailable for comment.

The case is the first enforcement action brought by Finra, which began operations Monday after being formed in a merger of the National Association of Securities Dealers and certain regulatory operations of the New York Stock Exchange.

The Kemper Lumbermens bonds, which were first sold in 1997 in private placements to institutional investors and wealthy individuals, later became available to individual investors. Although they offered interest rates of 8.3% and 9.15%, they declined steeply in price between 2001-03. Securities regulators launched an investigation after Morgan Stanley customers and brokers complained about the losses.

Morgan Stanley failed to review the markups, which were applied to the bonds in addition to brokerage commissions paid by the customers, Finra alleged.

Finra found the firm had marked up the \$59 million in bonds sold by a total of \$6.5 million -- of which \$3.9 million represented markups above the 5% limit. Finra ordered the firm to pay restitution of \$3.9 million plus \$721,000 in interest.

Write to Randall Smith at randall.smith@wsj.com¹

Hyperlinks in this Article: (1) <mailto:randall.smith@wsj.com>

Copyright 2007 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.