Morgan Stanley to pay $2M fine over First Republic stock sales

"Monitoring officers incorrectly concluded, after only one minute, that there was no relationship between the customer and First Republic."

SEP 06, 2024
By Leo Almazora

Morgan Stanley has been fined $2 million in Massachusetts for its role in the sale of First Republic Bank stock in the lead-up to its collapse in 2023.

According to a statement from the office of William Galvin, secretary of the commonwealth of Massachusetts, a former executive at the bank who was a client of Morgan Stanley sold substantial amounts of First Republic stock under the Wall Street giant's watch.

Galvin's investigations into potential insider trading prior to the implosion **began in March 2023**, in the immediate aftermath of the regional banking crisis.

As detailed in a consent order by Galvin's Securities Division, the executive, referred to as “Customer One,” sold over $6.8 million worth of First Republic shares between February 2022 and March 2023. These transactions occurred before First Republic stock experienced a significant drop, allowing the executive to sidestep substantial losses.

Reporting by **the Wall Street Journal** identifies the insider as then-Executive Chairman James Herbert II, whose trades reportedly matched details in the order. The investigation by Massachusetts didn't accuse Herbert of insider trading.

According to the order, the ex-First Republic executive unloaded more than $6.8 million worth of shares, including sales of $2.3 million in October 2022, $2.6 million in January 2023, and $1.2 million and $629,000 in February 2023. The final stock sale occurred just three days before the stock price collapsed. The executive had also made public statements regarding First Republic's financial health, which were later found to be inaccurate.

Morgan Stanley managed 19 accounts, including 18 brokerage and one advisory account, for the individual and his relatives.

An investigation by the securities division found Morgan Stanley failed to ensure the executive wasn't trading on material non-public information. Although its internal rules and compliance procedures prohibited trading based on material non-public information, the firm’s employees did not adequately verify whether the insider was following these rules.

According to the Journal, the team that should have overseen the trades determined they didn't need approval due to a quirk in securities laws. Because the FRB shares in question were technically under the regulation of the Federal Deposit Insurance Corporation rather than the SEC, the firm removed the coding that should have routed the trades for the team to check.

Morgan Stanley neither admitted or denied wrongdoing.

“In reviewing potential insider trading alerts, monitoring officers incorrectly concluded, after only one minute, that there was no relationship between the customer and First Republic,” Galvin's office noted **in a statement**.

The investigation also highlighted the use of off-channel communications by Morgan Stanley employees, an issue that has also landed the firm in hot water with the SEC **during an industry-wide probe in 2022**, which resulted in **a $125 million fine for the Wall Street bank**. In the First Republic case, the managing director responsible for handling the former CEO’s accounts reportedly used personal text messages that were not retained.

In addition to the financial penalty, Morgan Stanley has been instructed to review and improve its internal policies and provide training on insider trading prevention to its registered brokers in Massachusetts.