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THE WALL STREET JOURNAL.

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721 words
5 April 2022
The Wall Street Journal
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English

An investor accused Morgan Stanley of leaking information about a large sale of shares of Palantir Technologies Inc., saddling it with millions of dollars in losses.

Morgan Stanley is at the center of a federal investigation into whether Wall Street banks told favored clients about pending sales, known as block trades, that they were hired to carry out quietly. The investor, Disruptive **Technology** Solutions LLC, and affiliated funds on Monday filed a demand for arbitration against the bank with the Financial Industry Regulatory Authority, a copy of which was viewed by The Wall Street Journal.

Disruptive alleges that Morgan Stanley and a senior executive there leaked information ahead of the fund's sale of more than $300 million of Palantir shares in February 2021, resulting in "tens of millions of dollars in damages."

The Securities and Exchange Commission and Justice Department are investigating whether banks tipped off clients to block trades, in which insiders sell chunks of stock through a broker such as Morgan Stanley. Block trades tend to cause the stock in question to decline, so knowing about one ahead of time can help an investor gain on a short sale or avoid a loss by unloading shares that are already owned.

A Journal analysis of nearly 400 block trades between 2018 and 2021 found that 58% of the time the share price declined in the trading session immediately before the block trade, controlling for the performance of peer companies.

The analysis found that Morgan Stanley had the worst record of any of the biggest banks that are major players in block trading. When the bank executed block trades by itself, 62% of the stocks traded had negative market-adjusted returns in the trading session immediately before the block trade. The median stock in a Morgan Stanley block trade trailed its peers by 0.7 percentage point in the session.

Disruptive's arbitration demand cites the Journal's analysis. The Journal analysis found that of the 268 trades for which the Journal was able to determine how much the banks paid for blocks, the sellers would have received $382 million more if the stocks had performed in line with the benchmark, or about $1.4 million per trade.

The SEC has sought trading records and electronic communications from multiple large banks and hedge funds, the Journal has reported. Morgan Stanley, which the Journal has reported is a focus of the inquiries, disclosed in February that it has been responding to information requests from the Justice Department since last summer. In November, it put a senior executive in charge of block trading, Pawan Passi, on leave. Disruptive names Mr. Passi as a respondent in the demand for arbitration.

A Morgan Stanley spokeswoman declined to comment on behalf of the firm and Mr. Passi.

In its arbitration demand, Disruptive alleges it approached Mr. Passi about selling a chunk of its stake in Palantir in February 2021. In the lead-up to the sale, Disruptive said, Mr. Passi "falsely assured Disruptive that Morgan Stanley would keep information about the potential block trade secret within 'a closed circle.'"

Late on the afternoon of Feb. 17, 2021, Disruptive said, it provided Mr. Passi with the number of shares it planned to sell the following day before the stock market opened. "Immediately following that communication, Palantir's share price went into a free fall," Disruptive wrote. Palantir's stock, at one point that day trading at around $29 a share, closed at $27.08. Disruptive sold its block of Palantir stock to Morgan Stanley at $26.05 a share, for total proceeds of more than $343 million.

Disruptive alleges that Morgan Stanley either tipped off clients or its own proprietary-trading desk -- or both -- to the coming block. Disruptive doesn't present evidence aside from the stock-price move and media reports of the government investigations.

After the stock market closed Feb. 17, a representative of Disruptive who previously worked at Morgan Stanley texted Mr. Passi that "the stock got destroyed at the end," and this was "[n]ot a great look," according to the arbitration demand. The filing says Mr. Passi "vociferously denied" that Morgan Stanley had engaged in any form of front-running and disclaimed responsibility for the stock's fall in a call later that night.

Document J000000020220405ei450001t

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Timestamp	7 March 2025 3:32 AM GMT

