

A Morgan Stanley Crusader

Bond-Pricing Issues
Prompt One Broker's
Inside Investigation

By Randall Smith

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Last August, Wall Street firm Morgan Stanley and one of its senior traders agreed to pay \$6.1 million in fines and restitution to settle allegations that the investment bank overcharged brokerage customers on 2,800 purchases of \$59 million of bonds.

Dana de Windt, a Crucial Inside Source

Regulators investigating the case had a crucial inside source: Dana de Windt, a broker at the aquamarine, glass Morgan Stanley branch nestled among back-pain and varicose-vein-removal clinics in this small city on Florida's east coast.

For four years, the 60-year-old Mr. de Windt has been fighting a lonely war against his own firm. Saying he was convinced that Morgan Stanley cheated clients, Mr. de Windt complained to regulators, helped recruit customers to file damage claims and repeatedly tried to confront his bosses with questions tucked inside a thick, three-ring binder.

"These firms are such big bullies that they feel if they stonewall, you're eventually going to go away," he says. Morgan Stanley declined to comment on Mr. de Windt's version of events.

What makes Mr. de Windt an unusual adversary is that he fought so openly and aggressively against Morgan Stanley even while continuing to work there. His production plunged, and he says his boss in the Stuart office told him to get over it.

Morgan Stanley Tolerated de Windt's Rebellion

A Morgan Stanley spokesman says officials were aware of the broker's contacts with regulators but didn't retaliate. Senior Morgan Stanley executives also responded to his concerns, the spokesman adds.

“It definitely took a toll,” says Mr. de Windt’s son, Cullen, a tennis pro at a Palm City, Fla., country club. “It’s tough to do business and really be fired up when you are fighting the big boys to make sure no one gets taken.”

Part of de Windt’s Fury Was Personal

He joined Morgan Stanley in 1992 after working at E.F. Hutton & Co. and Prudential Securities. In 2001, Morgan Stanley sold customers in Florida and elsewhere \$59 million in bonds issued by Lumbermens Mutual Casualty Co., a property and casualty unit of Kemper Insurance Cos.

But the bonds lost their investment-grade rating in 2002 because of deterioration in the insurer’s finances. The bonds eventually plunged 90% or more in value. And Mr. de Windt discovered that his 87-year-old father owned \$65,000 of the battered securities.

Brokers at Morgan Stanley Started Raising Questions

Michael Blankenship, another broker in the Stuart office, had bought about \$700,000 of the bonds for seven or eight clients. Then he noticed that the bonds reflected a market value about 20% lower than the purchase price once they were put in client accounts.

Mr. Blankenship was told the prices were in error, according to documents filed in an arbitration case.

In a 2003 meeting about the bonds, according to people familiar with the meeting, Mr. Blankenship tangled with a Morgan Stanley lawyer over the phone. Asked by the lawyer what Mr. Blankenship normally did when an investment fell in price, the broker heatedly replied that there was “nothing normal” about the Kemper bonds, which had quickly “turned to dust,” the same people said.

Morgan Stanley fired Mr. Blankenship ten days later, saying he had improperly covered a customer’s losses after a trading mix-up. Mr. Blankenship later argued he was fired in retaliation for his complaints about the bond losses.

Mr. de Windt, the top producer in his branch in 2003, inherited some of Mr. Blankenship’s clients. They included retired electrician Richard Mittnacht Jr., who wrote a letter to Mr. de Windt complaining that he had been “intentionally misled” by the Morgan Stanley bond desk into believing the bonds were a “safe haven.”

de Windt Pushed for Answers From Morgan Stanley

Over the next year, Mr. de Windt pushed for answers from top Morgan Stanley executives. He buttonholed Bruce Alonso, a former senior brokerage executive, at a meeting for top producers at a Scottsdale, Ariz., resort; Mr. Alonso had an aide reply. Morgan Stanley declined to comment and Mr. Alonso couldn't be reached. And after an in-house lawyer said Morgan Stanley intended to fight customer complaints about the bonds, since the firm had deemed them "suitable," Mr. de Windt showed up at her office in New York, he says. She wasn't there.

In 2004, Mr. Mitnacht filed an arbitration claim to recover his losses on the Kemper bonds. Mr. de Windt acknowledges encouraging other brokerage customers to join the arbitration. Five of the six customers reached a settlement in 2005 that gave them back 50% of their losses. In a separate claim, one couple got 94% of their original investment.

de Windt Wasn't Satisfied With Arbitration Settlement

He went to the National Association of Securities Dealers with his complaints. After a response he considered encouraging, he had bright-yellow golf tees printed with the words: "nasd examination."

In 2006, Mr. de Windt testified in Mr. Blankenship's wrongful-termination arbitration against Morgan Stanley, saying he believed Mr. Blankenship had been fired because of the broker's blast at the firm lawyer. During the proceeding, a Morgan Stanley lawyer confronted Mr. de Windt about recruiting investors who complained about the bonds' losses. Mr. Blankenship lost the case, but Morgan Stanley's effort to recover money from him also was thrown out.

Mr. de Windt eventually became worried that the NASD was dragging its feet. At a conference in New York last year, the broker says he pressed a senior NASD official for 10 minutes, before being edged aside by someone else. A spokeswoman for the agency, Nancy Condon, said the complex case involved analysis of thousands of transactions and was being handled by an NASD office in New Orleans when Hurricane Katrina hit.

FINRA's Complaint

Last August's complaint by the Financial Industry Regulatory Authority, which includes the NASD's enforcement arm, asserted that Morgan Stanley charged excessive markups and had an inadequate supervisory system for monitoring the pricing of bonds sold to customers.

Morgan Stanley notes that it neither admitted nor denied wrongdoing in settling the charges, adding that regulators didn't accuse the firm of improper sales practices.

Mr. de Windt says he still believes the markups helped Morgan Stanley deceive customers about the risk of the bonds, since their yields were below the 10% level that can be a red flag for many investors. "If they had priced them legally, it would have shown they were junk," he says.

He Continues to Fight

Mr. de Windt has filed a new arbitration claim on behalf of his father and is seeking internal emails about the 2001 bond sale. Last month, though, he retired from Morgan Stanley, saying he couldn't in good conscience urge customers to make new investments through the firm.