U.S. Securities and Exchange Commission
Market Structure Roundtable
Undisplayed Liquidity Panel
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Good afternoon – I'm Andrew Silverman, the global co-head of Morgan Stanley's Electronic Trading business. I'd like to thank the Commissioners and Trading & Markets staff for giving me this opportunity. I look forward to our discussion and to presenting Morgan Stanley's views on the important topic of Undisplayed Liquidity.

Morgan Stanley's approach to trading in electronic markets emphasizes protecting the confidentiality of customer order information while achieving Best Execution consistent with our customers' instructions. Our business model and trading engines are designed carefully to limit the amount of order information communicated to third parties. Over the past several years, we have been outspoken with respect to some of the aggressive order handling and routing practices that have evolved in the US equity markets. We have advocated for increased transparency and meaningful disclosures to shape informed customer decision making, and have pointed out a number of practices that we have found troubling. However, we continue to believe that the fundamental condition of the US national market system is sound and that the equity markets as a whole do an excellent job of meeting the needs of investors, traders and the capital markets.

The issue of Undisplayed Liquidity is not new. Exchanges and trading crowds have always existed and traders have always sought to shield their true interest from the entire marketplace in order to get the best price for their customers. Enhancements in technology have allowed Undisplayed Liquidity to continue to play a critical role in today's market structure. Undisplayed Liquidity enables investor choice, enhances competition, allows for innovative business models and improves overall execution quality.

Undisplayed Liquidity takes many forms and serves the entire range of market participants – including both retail and institutional; and long and short term investors. Undisplayed Liquidity can be thought of in four main categories:

1) Truly Dark Pools that allow orders to passively interact while eliminating pre-trade information leakage and market impact;
2) Dark Pools and Enhanced/Alternative Liquidity Providers that solicit orders and disseminate order information;
3) Exchange Dark Order Types that offer partially or completely hidden liquidity on an exchange's book; and
4) Broker Internalization – whereby brokers perform their historical roles of matching buyers and sellers and committing capital.

We believe that it is inadvisable to treat all forms of Undisplayed Liquidity the same. The rule sets for Undisplayed Liquidity should be different, but the guiding principles remain the same – transparency, efficiency and fair competition between venues, all in the pursuit of Best Execution.

In its efforts to examine the interaction of displayed and undisplayed liquidity, and the potentially negative impact of Undisplayed Liquidity on price formation and execution quality, the Commission has asked for comment on a number of potential solutions. We'd like to highlight our views on these key issues relating to Undisplayed Liquidity.

Fair Access

Morgan Stanley's Dark Liquidity is truly dark – and our liquidity pools are carefully constructed and monitored to provide a level playing field and to maximize the potential benefits for our customers. We do not believe that Dark Pools should be forced to provide unfettered direct access to all forms of aggressive and potentially predatory order flow. Any regulation in this area needs to be flexible enough to account for differences in business models and to recognize the unique characteristics of truly dark liquidity pools that do not solicit or disseminate order information. Such regulation also requires improved transparency with respect to order routing and handling practices so that customers are empowered to make informed, appropriate decisions when routing their flow.

Trade At

Trade At would essentially require a broker to "take out" all top of book protected quotations (and more price levels if the Depth of Book approach was layered on) before it can execute an order at the same price for customers. Such an approach would effectively put most continuous match dark pools that execute at the NBBO out of business. It would also hinder brokers' ability to commit capital, prevent auto execution of customer orders, and effectively prohibit upstairs crossing by broker-dealers holding natural contra-side interest.

A Trade At regime is a Draconian solution in search of a problem. It should not be implemented. To reiterate, Undisplayed Liquidity plays a critical role in today's market structure. A Trade At regime will not magically result in on-exchange trading of fully transparent orders. We think a far more likely result is that orders will move back upstairs to traders' or portfolio mangers' desks as they fear the impact that wide spread dissemination of their order information will have on execution quality.

Depth of Book

Depth of Book protection would extend the existing Regulation NMS top of book protection down to all price points on the protected markets. Morgan Stanley strongly opposes Depth of Book protection for the same reasons that we did when it was considered as part of Regulation NMS. The difficulties and impracticalities of Depth of Book were clearly recognized by the Commission in the adoption of Regulation NMS. Depth of Book was a bad idea when Regulation NMS was adopted – and it remains a bad idea today. In fact, the proliferation of protected quotations and the ever expanding universe of exchanges suggest that this would be an even more unworkable approach in today's market structure environment.

Low-Priced Stocks

The SEC is considering whether to implement a pricing increment smaller than a penny for low-priced stocks. Morgan Stanley agrees that many low-priced stocks are trading off exchange because the spread, as measured in basis points, is relatively much larger for those stocks, and because dark liquidity provides mechanisms to reduce the spread and incentives in the form of liquidity rebates.

Before reaching a final determination on pricing increments, it is important to note that for many securities, including low-priced stocks, the overall spread can already be reduced with the use of hidden/dark midpoint pegged and other formulaic order types. Currently, most exchanges and ATSs (including ECNs and dark pools) offer and use mid-point pegged orders. However, due to the disparate regulation of exchanges and ATSs, ATSs are able to more readily offer formulaic order types and thus can implicitly price orders in sub-penny increments, despite the SEC's explicit rule prohibition. Morgan Stanley's view is that sub-penny pricing may be appropriate for certain low-priced stocks. However, current behavior (including mid-point/formulaic order types and liquidity rebates/access fees) must be carefully examined before determining whether it is necessary or appropriate to revisit the minimum price increment for low-priced stocks.

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Thank you again for this opportunity. I commend the Commission for its willingness to tackle these complex and important issues and look forward to answering your questions.