

MEMORANDUM

To: File No. S7-23-15

From: Jill S. Henderson
Counsel to Commissioner Kara Stein
U.S. Securities and Exchange Commission

Date: August 5, 2016

Re: Meeting with Representatives from Morgan Stanley

On July 26, 2016, Jill Henderson and Mellissa Duru met with Bill Neuberger, Andrew Silverman, Sapna Patel, and Joyce Tavoulareas of Morgan Stanley. Topics discussed included the Commission's proposal regarding Regulation of NMS Stock Alternative Trading Systems.

Attachment: Morgan Stanley Institutional Equity Division ATS-N Proposal/Dark Pool
Transparency Slide Presentation

Institutional Equity Division

ATS-N Proposal / Dark Pool Transparency

July 2016

Table of Contents

- I. History of Morgan Stanley's Views on Order Handling Practices
- II. Objectives of the ATS-N Proposal
- III. Morgan Stanley's Suggested Approach
- IV. Specific Comments on the ATS-N Proposal
 1. Broker Disclosure Should Be Uniform
 2. ATSS Have Distinct Models and Are Not Exchanges
 3. Disclosure Obligations Should be Meaningful and Not Unduly Burdensome
- V. Appendix – Dark Pools - Frequently Asked Questions

History of Morgan Stanley's Views on Order Handling Practices

For many years, Morgan Stanley has publicly advocated for more detailed disclosures to clients regarding the manner in which brokers handle their orders, including with respect to any dark pools that they may operate.

Morgan Stanley ATs

1999 ATS-1 (MS Trajectory Cross)

2006 ATS-4 (MS POOL)

2011 ATS-6 (MS RPOOL)

2008	Series of presentations to inform clients and regulators globally of various dark pool and aggressive broker order handling practices ("Shades of Gray")
2008	Questions for Clients to Ask of Their Dark Pool Providers
2009	Comment Letter on NASDAQ / BATS Flash Orders
2010	Comment Letter on SEC's Dark Pool / IOI Proposal
2010	Questions for Clients to Ask Brokers re Order Handling Practices
2010	SEC Market Structure Roundtable – Dark Liquidity Panel Statement
2011	Presentation to the SEC on Order Handling Practices and Disclosures
2013	Presentation to the SEC on an Update on Equity Market Structure
2014	Note to Clients – Morgan Stanley's Views on Equity Market Structure
2015	Presentation to the SEC on Order Handling Transparency
2015	SEC EMSAC Meeting – Regulatory Structure of Trading Venues Panel
2016	Comment Letter on ATS-N / Dark Pool Transparency Proposal

Morgan Stanley's public comment letters, presentations and statements on various market structure topics are available at <http://www.morganstanley.com/institutional-sales/mset-regulatory-communications>.

Objectives of the ATS-N Proposal

“The Commission preliminarily believes that if market participants have more information about the operations of NMS Stock ATSS they could better evaluate whether to do business with an ATS and make more informed decisions about where to route their orders”.... “[t]he Commission preliminarily believes that the proposal could facilitate comparisons among trading centers....” (ATS-N Proposal, pp. 19-20)

- In light of recent scrutiny around electronic trading, clients have been asking for more detailed information about dark pool / ATS operations and broker order handling practices generally
- Specific questions regarding dark pool / ATS operations related to:
 - Matching logic
 - Categorization of participants
 - Counterparty selection
 - Prioritization of orders
 - Order types
 - Market data feeds used
 - Access and priority of operator and its affiliates
- In the absence of any standardized, mandated public transparency, clients are **receiving varying levels of information from their brokers that is often not consistent or easily comparable**
- Clients are entitled to **concise, meaningful and comparable disclosures** about how their orders are being handled

Morgan Stanley's Suggested Approach

- We believe that the SEC should address client concerns by mandating broker-dealer ATS operators to **publicly disclose**:
 - Current and historical Form ATS filings (and related amendments)
 - Responses to a standardized set of specific questions typically asked by clients regarding ATS operations like those set forth in the Appendix
- **Standardization and specificity are the key to concise, comparable and meaningful information** for ATS users regarding dark pool / ATS operations
- This approach is a **more balanced and appropriate transparency solution** with the added benefits of being less burdensome and faster to implement
- Regulators can continue to request any additional confidential information from ATSs and their broker-dealer operators
- We are concerned that proposed Form ATS-N will result in subjective narrative responses that will not lend themselves to side-by-side comparison

Broker Disclosure Should Be Uniform

- Under the ATS-N Proposal:
 - Broker-dealer operators of ATSs would be held to a **higher standard** than broker-dealer operators of non-ATS crossing platforms / internalization mechanisms
 - ATS operators would be required to disclose publicly, and in significantly greater detail, more information about **their overall trading infrastructure** than a broker that does **not** operate an ATS
 - Broker-dealers may be incentivized to seek alternatives to operating an ATS
- As a policy matter, transparency around broker order handling practices is relevant to the investing public **regardless of whether such activity is effected by a broker-dealer that happens to operate an ATS**
- Any disclosure around broker trading infrastructure and order handling practices beyond ATS operations should apply to **all brokers**, including exchange brokers

Exchanges

Protected

Required to access

ATSs

Not Protected

Client choice whether to access

ATSs Have Distinct Models and Are Not Exchanges

- ATSs are **an evolution and automation of a fundamental broker-dealer function** to match client orders with contra-side liquidity based on the clients' instructions
- The ATS regulatory structure created under Regulation ATS serves a different public policy objective from the exchange regulatory structure – it allows for innovative models to be operated by broker-dealers to provide distinct liquidity offerings to meet client needs
- ATS-N Proposal should recognize the **materially different roles** that ATSs and exchanges are intended to play in the U.S. marketplace
- An ATS may be part of a **broader, integrated electronic offering** available to clients choosing to access the markets through a full-service broker-dealer
- Proposal treats all ATSs as standalone, exchange-like price/time priority models – it fails to account for distinct ATS models which clients may choose to access
 - Price/capacity/size priority
 - Interval VWAP crossing
- While certain ATSs may actively compete with exchanges and solicit order flow to maximize their own market share, we **cannot** lose sight of the original objectives of Regulation ATS and the benefits of different ATS models to clients

Disclosure Requirements Should Be Meaningful and Not Unduly Burdensome

- Certain disclosures would **not be meaningful to ATS users**, could, in fact, **inhibit useful comparison of ATSS**, and create unnecessary and burdensome disclosure obligations
- Disclosures should be tailored such that the information elicited would provide information on which ATS users can make informed decisions
- Examples from Proposed Form ATS-N:
 - Requirement that a broker-dealer list **all** affiliates and business units that **may** trade on the subject ATS, and
 - Requirement to provide detailed information regarding persons, **including natural persons**, providing services for the ATS, but who are unaffiliated with the broker-dealer
- Lists of hundreds of affiliates and every service provider are **not** useful
- What would be meaningful to an ATS user: whether affiliates or service providers who may access the ATS **get any preferential and/or differentiated treatment**

Appendix

Dark Pools - Frequently Asked Questions

[Firm Name]
[Dark Pool Name] - Frequently Asked Questions
(Last Updated: [Date])

(Firms that operate more than one dark pool must provide responses for each dark pool that they operate.)

1. Please describe the Firm's internal dark pool.
2. How can the Firm's dark pool be accessed?
3. What market data feeds does the Firm's dark pool use?
4. Does the Firm match orders at the best bid or offer and/or offer price improvement, including midpoint matches?
5. Can clients specify limit prices within the spread to control where within the spread their orders will match?
6. Describe the types of participants in the Firm's dark pool.
7. Does the Firm allow participants to opt out of interacting with certain flow in its dark pool?
8. Does the Firm classify or categorize participants in its dark pool?
9. How does the Firm's dark pool prioritize orders?
10. What order types are supported by the Firm's dark pool?
11. Can clients specify a minimum fill quantity in the Firm's dark pool? If so, will the dark pool aggregate orders to satisfy the minimum fill quantity?
12. Does the minimum fill quantity constraint apply to just the first execution or to every execution?

Dark Pools - Frequently Asked Questions (cont'd)

13. Does the Firm's dark pool (or smart router, algorithm or any other Firm electronic trading system) send outbound IOIs (or messages similar to an IOI, including an RFQ, RFL, SOI, SOQ or SOL) to solicit order flow?
14. Does the Firm's dark pool route to any external venues or participants?
15. During which hours does the Firm's dark pool execute?
16. Does the Firm provide preferential access to its dark pool or to categories of flow in its dark pool for a fee? Do orders in the Firm's dark pool from other brokers with which the Firm has a mutual access agreement receive preferential treatment?
17. Where is the Firm's dark pool server located and does the Firm permit participants to cross-connect?
18. Does the Firm offer co-location in its dark pool's cage?
19. How does the Firm's dark pool handle odd lot and mixed lot orders?
20. Does the Firm execute in a locked or crossed market?
21. What are the MPID, the MIC code and the clearing number for the Firm's dark pool?
22. Does the Firm's dark pool employ a maker-taker pricing model or provide rebates to solicit order flow?
23. Does the Firm's dark pool charge different rates for access to different types of order flow?
24. What is the average daily volume of the Firm's dark pool?
25. What anti-gaming controls does the Firm have in place for its dark pool?
26. Does the Firm's dark pool execute orders for symbols that may be suspended for purposes of the 5% volume threshold of Regulation ATS, restricted and/or halted?



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