Morgan Stanley

March 31, 2023

Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Securities Exchange Act Releases No. 34-96493, 34-96494, 34-96495 and 34-96496 (File Nos. S7-29-22, S7-30-22, S7-31-22 and S7-32-22) – Equity Markets and Best Execution Proposals

Dear Ms. Countryman:

Morgan Stanley appreciates the opportunity to provide comments to the U.S. Securities and Exchange Commission (the "**Commission**") on its four proposals related to U.S. equity markets reforms and best execution standards (the "**Proposals**").[1]

Morgan Stanley operates leading wealth management and institutional franchises that facilitate a broad and deep range of investors' access to U.S. equity, listed options and fixed income markets. In particular, our wealth management franchise supports more than 18 million client relationships through our advised, self-directed and workplace channels. Morgan Stanley's retail and institutional clients execute a significant volume of transactions in the U.S. equity, listed options and fixed income markets each business day.

We support efficient, fair and well-regulated U.S. capital markets that promote investor access and customer protection. We believe that U.S. retail investors today—before application of changes contemplated by the Proposals—benefit from a range of equities investing models, including access to low- or zero-commission platforms, and have access to deep, liquid markets that support their wealth management goals as well as broader capital formation for the U.S. economy. While we support certain proposed enhancements as set forth herein, we respectfully submit that the Commission should disclose data and analysis concerning specific shortcomings in the existing market framework, as well as how the proposed standards would address those shortcomings and benefit investors, for public review and comment before taking further action on the Proposals.

Morgan Stanley supports comments on the Proposals submitted by the Securities Industry and Financial Markets Association and the Committee on Capital Markets Regulation, particularly where these letters request that the Commission provide more quantitative analysis in support of the Proposals. We are submitting this letter to highlight specific issues important to our clients and relevant to our business model.

[1] Securities Exchange Act Release No. 34-96493 (Dec. 14, 2022), 88 FR 3786 (Jan. 20, 2023) (Disclosure of Order Execution Information Proposing Release); Securities Exchange Act Release No. 34-96494 (Dec. 14, 2022), 87 FR 80266 (Dec. 29, 2022) (Reg NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders Proposing Release); Securities Exchange Act Release No. 34-96495 (Dec. 14, 2022), 88 FR 128 (Jan. 3, 2023) (Order Competition Rule Proposing Release); and Securities Exchange Act Release No. 34-96496 (Dec. 14, 2022), 88 FR 5440 (Jan. 27, 2023) ("Regulation Best Execution Proposing Release").

I. Executive Summary

Morgan Stanley believes that all four of the Proposals are interconnected and, accordingly, we are submitting a single comment letter in response. However, we have distinct comments on each of the Proposals, as summarized below.

- ***Reg NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders Proposal*** – We support the Commission revisiting the one-size-fits-all tick size and lowering the 30 mils access fee cap. However, we believe that the complex mechanics of this proposal may not be well-designed to achieve the Commission's policy objectives. For example, we believe that parts of the proposal may result in a loss of price improvement opportunities and liquidity for retail investors. As an alternative, we recommend that the Commission consider a dynamic tick size approach with the access fee cap proportionally tied to both smaller and larger tick sizes (for minimum quoting increments only). Our recommendations in this area align with suggestions we submitted to the Commission in 2018.[2]

- ***Order Competition Rule Proposal*** – We respectfully recommend that the Commission not adopt this proposal. We believe that mandating retail auctions—while continuous trading occurs ahead of, or in response to, such delayed auctions—could adversely affect market liquidity and competition, introduce additional market and operational risks, increase trading costs for investors, and ultimately lead to worse executions for retail investors than they receive today for marketable orders from wholesalers. Instead, we recommend that the Commission consider changes to existing exchange retail liquidity programs ("**RLPs**") to make them more competitive.

- ***Regulation Best Execution Proposal*** – We respectfully recommend that the Commission not adopt this proposal. Existing Financial Industry Regulatory Authority ("**FINRA**") and Municipal Securities Rulemaking Board ("**MSRB**") best execution standards have served investors well, and imposition of a more prescriptive standard by the Commission may impair, in some cases, broker-dealers' ability to execute clients' orders efficiently and effectively at favorable prices. In addition, this proposal may have specific negative impacts on broker-dealers' ability to support liquidity in fixed income markets.

- ***Disclosure of Order Execution Information Proposal*** – We support the Commission's effort to update Rule 605 to provide additional transparency to investors. We recommend a staggered approach to any changes to U.S. equity market structure, starting with changes to Rule 605 as a baseline for measuring retail execution quality before any changes to tick size, access fee cap, lot size or other standards contemplated by the Proposals are introduced.

---

[2] *See* Morgan Stanley comment letter on the Commission's Transaction Fee Pilot, dated Jun. 14, 2018 (https://www.sec.gov/comments/s7-05-18/s70518-3892685-162917.pdf) and Morgan Stanley presentation to the Commission, Regulation NMS Evolution, dated May 1, 2018 (https://www.sec.gov/comments/s7-05-18/s70518-3592870-162343.pdf).

II. Reg NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders Proposal

This proposal touches on all aspects of Regulation NMS—tick sizes, access fees and lot sizes—and therefore would broadly impact investors in U.S. equities. This proposal is taking three things that are effectively static today across NMS stocks—tick sizes, access fee caps and lot sizes—and would make them dynamic, requiring market participants to make frequent changes to their systems. While complexity in and of itself is not a reason to retain legacy standards, the risk of technology failure created by monthly and/or quarterly changes to systems by the buy-side, sell-side, exchanges and vendors (including security information processors) may introduce new market and operational risks.[3] Moreover, this dynamic aspect of the proposal could create investor confusion and potentially drive trading inefficiencies.

We highlight below some of the issues raised by the Commission's proposed tick sizes and access fee caps as well as recommend an alternative approach that we believe would more appropriately tie access fee caps to dynamic tick sizes.

Specific Issues Raised by the Proposal's Tick Size / Access Fee Cap Approach

Loss of Retail Price Improvement Due to the Proposed Minimum Trading Increment – The proposal would require a minimum trading increment as part of the tick size changes—i.e., it would require that executions occur at the same increments as the proposed new minimum quoting increments. While the exceptions for midpoint and benchmark executions largely result in less impact to institutional investors, retail investors may lose some of the price improvement and liquidity that they receive today, especially for thinly traded securities.

Tick Size / Access Fee Cap are Disproportionately Tied – While the Commission acknowledges the tie between tick sizes and access fee caps, the proposal's four tick sizes ($0.001, $0.002, $0.005 and $0.01) and two access fee caps (5 mils and 10 mils) could lead to trading inefficiencies given that both factor into the overall economics of an execution and are not proportionately aligned. For example, while a 10 mils access fee cap for a $0.01 tick size may be appropriate, a 10 mils access fee cap for a $0.002 tick size may be disproportionately high.

Morgan Stanley's Alternative Tick Size / Access Fee Cap Approach

Consistent with our 2018 recommendations, Morgan Stanley supports a dynamic tick size approach with the access fee cap proportionally tied to both smaller and larger tick sizes (for minimum quoting increments only).[4] We believe that the access fee cap should be a certain percentage of the minimum quoting increment (e.g., 10%). This would result, for instance, in a 5 mils access fee cap for a smaller $0.005 minimum quoting increment, a 10 mils access fee cap for the current $0.01 minimum quoting increment, and a 50 mils access fee cap for a larger $0.05 minimum quoting increment based on characteristics of the stock (e.g., quoted spread, turnover, market capitalization, stock price, share and/or notional volume). We are not recommending a specific percentage for the actual fee cap and encourage

---

[3] The increase in messaging traffic required by this proposal would introduce other infrastructure-related costs, including with respect to market data and Consolidated Audit Trail obligations.
[4] *See supra* note 2.

the Commission to conduct empirical analysis, including with respect to impacts on liquidity at exchanges, to support any such calibration.

Reducing the minimum quoting increment to a minimum of $0.005 for certain tick-constrained stocks that would otherwise trade with a tighter spread may be appropriate. For higher priced stocks, increasing the minimum quoting increment to an increment larger than $0.01 may be appropriate. This solution would more appropriately tie access fee caps to the various minimum quoting increments, and would not raise the same concerns as under the proposal. As mentioned above, we do not support a minimum trading increment, as it could harm retail clients by resulting in a loss of price improvement and liquidity for their orders.

III. Order Competition Rule Proposal

Retail investors fare well today in the current U.S. equity markets environment. They have access to low- or zero-commission platforms and receive immediate execution of their market orders at prices generally better (and often considerably better) than publicly quoted market prices due to the current market structure and resulting competition among market participants to provide price improvement. Any changes related to retail order handling should be carefully contemplated to preserve these benefits for retail investors and ensure that they are not harmed.

Retail brokers are best positioned to understand the needs of their retail clients. By mandating retail auctions, the proposal would, in effect, impose order routing decisions on retail brokers. For the reasons provided below, we do not believe that a regulatory mandate to route retail orders to such auctions is in the best interests of our retail clients.

The prescriptive requirements around the Commission's proposed auctions may harm retail investors in several respects, including due to information leakage with others trading ahead of (or in response to) retail orders, delay of execution and the market potentially moving away, potential for lack of liquidity, no guarantee of an execution, and increased trading costs. In addition, as the NYSE outage on January 24, 2023, around its opening auction demonstrated, there is considerable risk to the system in being overly reliant on exchanges, which may invoke limited liability rules for their own systems and operational failures, leaving retail investors with insufficient recourse for auction failures.

Most concerning is that the mandated-auction feature of the proposal may inhibit retail clients' ability to obtain efficient order execution and best pricing. Under current standards, it is relatively common for a retail client's marketable order to be routed to a wholesaler that has guaranteed immediate execution of such orders, typically at prices that improve upon the National Best Bid and Offer ("**NBBO**") at the time the order was received (and with the retail client paying low to zero commissions). Under this proposal, by contrast, if the wholesaler is not willing to execute at the midpoint, the mandated retail auction will result in dissemination of the retail client's order, which other market participants may interpret as resulting from the wholesaler's unwillingness to execute at the midpoint. These market participants, in turn, may change their offers on another exchange's continuous book in response to this information, which would change the NBBO for executing the retail client's order. While there are several permutations of eventual outcomes—including that the retail client is unable to execute their order or receives a price that is inferior to the NBBO at the time the order was received due at least in part to

execution latency and information leakage that is reasonably anticipated to occur—this example highlights the effect of continuous trading during a multi-step execution process involving mandated auctions.

The proposal would also prevent broker-dealers who have knowledge of retail orders sent to an auction from posting contra-side orders on the exchange auction operator's continuous book (given that continuous orders have priority at the same price over auction responses). In addition, as proposed, and absent any information barrier or aggregation unit scope limitations, this knowledge prohibition could deter wholesalers and other broker-dealers from being willing to accept and route retail orders because they would be prohibited from providing liquidity or facilitating liquidity on behalf of their other clients on the exchange auction operator's continuous book. As a result, retail orders could experience diminished liquidity.

Given the above concerns regarding the proposal's retail auction framework, the Commission could instead evaluate ways to make exchange RLPs more successful by broadening regulatory relief already provided to the exchanges over a decade ago to segment retail order flow and provide executions as granular as $0.001.[5] We respectfully submit that improvements to the current exchange RLPs would be a better place for the Commission to start rather than introducing the delayed retail auction construct into the U.S. equity markets, which could adversely impact retail executions.

IV. Regulation Best Execution Proposal

Morgan Stanley is committed to executing clients' orders efficiently, fairly and reliably, including in periods of market volatility. We have developed and refined our best execution practices, policies and procedures over many years in accordance with the best execution standards of FINRA Rule 5310 and, for municipal securities, MSRB Rule G-18, as well as associated regulatory guidance. The FINRA and MSRB best execution rules provide principles-based standards for broker-dealers that allow them to execute transactions based on a range of considerations that may be difficult to prescribe in advance by regulation. Indeed, we believe the FINRA and MSRB best execution rules effectively address a diverse range of broker-dealer business models. Imposition of the proposal's best execution rule may impair, in some cases, broker-dealers' ability to execute clients' orders efficiently, fairly and reliably.

While the proposal would follow FINRA and MSRB precedents in some respects, it is more prescriptive, which could result in worse executions for certain transactions. For example, the proposal would require broker-dealers to seek market centers where midpoint liquidity may be available. However, midpoint liquidity is not visible when routing an order, so this mandated search could result in multiple routes of a single order, introducing latency and information leakage that could ultimately work to the

[5] Securities Exchange Act Release No. 67347 (July 3, 2012), 77 FR 40673 (July 10, 2012) (Order Granting Approval to Proposed Rule Changes, as Modified by Amendments Nos. 1 and 2, Adopting NYSE Rule 107C to Establish a Retail Liquidity Program for NYSE-Listed Securities on a Pilot Basis Until 12 Months From Implementation Date, and Adopting NYSE Amex Rule 107C to Establish a Retail Liquidity Program for NYSE Amex Equities Traded Securities on a Pilot Basis Until 12 Months From Implementation Date, and Granting Exemptions Pursuant to Rule 612(c) of Regulation NMS); Securities Exchange Act Release No. 68937 (February 15, 2013), 78 FR 12397 (February 22, 2013) (Order Granting Approval to Proposed Rule Change, as Modified by Amendment No. 1, to Establish the Retail Price Improvement Program on a Pilot Basis until 12 Months from the Date of Implementation).

client's detriment. Where retail marketable orders are concerned, time is of the essence, particularly as broker-dealer execution quality is measured by comparison to the prevailing NBBO at the time the order was received by the broker-dealer.

We also believe that the conflicted transactions provisions of the proposal could introduce new frictions without necessarily improving execution quality. Requiring a broker-dealer to examine additional sources of liquidity for a transaction in this category may have limited practical benefit for clients. As proposed, the conflicted transaction provisions may also result in subjective application of the standard or its technical requirements. In addition, compliance with the proposal's provisions applicable to conflicted transactions could delay executions of client orders and cause broker-dealers to not preference certain exchanges that pay rebates as well as affiliated market makers from their order routing. We do not believe such exclusions would improve retail investors' execution quality or liquidity.

These considerations are amplified by the fact that the best execution proposal applies not only to marketable retail equity orders but also to transactions in fixed income securities and other products. The proposal raises specific challenges for the fixed income markets, where there are far more securities than in equity markets, many of which are very thinly traded and lack continuous, firm two-sided quotations. In addition, many fixed income transactions are executed by broker-dealers on a principal basis, which the proposal would treat as conflicted transactions. This outcome would not only create new challenges for broker-dealers seeking to facilitate investors' fixed income transactions but would also, more importantly, impact liquidity for individual clients and the market more broadly.

As such, we respectfully encourage the Commission to specifically consider the proposal's potential impacts to liquidity in fixed income markets. As highlighted elsewhere in our comments, we believe that there should be compelling analysis of specific shortcomings and clear evidence supported by publicly disclosed quantitative analyses of a superior approach before adopting any changes. In this case, there appears to be a meaningful risk of diminished liquidity from broker-dealers (or their affiliates), and current practices might otherwise achieve more favorable pricing for investors. Further, a mandate to submit requests for quotations (RFQs) to additional liquidity sources in the case of conflicted transactions could have a negative impact on liquidity, providing a false sense of inquiry and liquidity in the market. Broker-dealers have developed practices, policies and procedures in response to these and other unique features of fixed income markets to maximize liquidity, consistent with their existing best execution and fair pricing obligations. Taking all these considerations into account—existing investor protection standards, the fragmented nature of the fixed income markets, and the potential removal of clients' broker-dealers as liquidity sources—we are concerned this proposal would result in adverse impacts, rather than a superior approach, for retail investors' fixed income transactions.

V. Disclosure of Order Execution Information Proposal

Morgan Stanley supports the Commission's proposal to update Rule 605 to incorporate market structure, trading and technology advances over the last two decades. The proposed updates to the rule are largely in line with industry recommendations, although some refinements may be warranted, especially to clarify certain undefined terms. We recommend that the Commission adopt revisions to Rule 605 prior to any changes to tick size, access fee cap or lot size standards. Prioritizing Rule 605 revisions as a first

step would allow the Commission to coherently assess changes in execution quality and the potential need for further revisions.

Finally, we respectfully request that the Commission provide a sufficient implementation period for Rule 605 changes after adoption of a final rule. The proposed amendments to Rule 605 involve a host of changes, including the introduction of new order types in scope, which will require broker-dealers and their vendors to adopt new processes and controls.

VI. Conclusion

Morgan Stanley supports the Commission's efforts through the Proposals to evaluate U.S. equity markets and best execution standards for potential enhancements. We believe, however, that adoption of any final rules should be clearly supported in each case by compelling analysis demonstrating that revised standards would address identified shortcomings with current market practices. In addition, we respectfully urge the Commission to consider how revisions may impact retail and institutional investors and introduce new operational complexities and risks into U.S. capital markets. We would welcome the opportunity to discuss the Proposals and our views further with the Commission.

Respectfully submitted,

Andrew M. Saperstein
Co-President

cc: Gary Gensler, Chairman, U.S. Securities and Exchange Commission
Hester Peirce, Commissioner, U.S. Securities and Exchange Commission
Caroline Crenshaw, Commissioner, U.S. Securities and Exchange Commission
Mark Uyeda, Commissioner, U.S. Securities and Exchange Commission
Jaime Lizarraga, Commissioner, U.S. Securities and Exchange Commission
Haoxiang Zhu, Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets