Morgan Stanley Faces Off Against HFTs

Countering the speed advantages and trading tactics of high-frequency traders has become a major preoccupation for institutional brokers these days. That's because their customers are fretting they are at a disadvantage to the black boxes.

At Morgan Stanley, educating its customers is an important part of assuaging their fears.

"There's a lot of paranoia out there," Bill Neuberger, Morgan Stanley's co-head of electronic trading, said at this year's STA conference. "So we are providing our customers with a lot of detail and transparency. We may not have a speed advantage, but we do have one big advantage: the order. So we have the full picture of what the client wants to do. That's the most important piece of information."

Understanding how HFTs operate is key, Neuberger noted. While the big broker will try to use off-board venues as much as possible, ultimately it might route the order to the exchanges. The modus operandi of HFTs is to post as many quotes as possible until they detect "natural," or buyside flow. Then they cancel their quotes and start trading. "You will see a lot of prints go off and then a lot of cancels," Neuberger said. "We have 99 percent cancel ratios."

To combat this behavior Morgan Stanley incorporates randomizing into its algorithms and smart order routing. That way, it varies the timing of the executions and the choice of venues, hopefully throwing any tape-watcher off the scent.

What the broker doesn't do, Neuberger explained, is blind ping. It knows HFTs are waiting in certain venues. It also doesn't take out HFT quotes immediately. "Those practices are overly aggressive," Neuberger said.