

Who is Trading Your Stock?



On Sept. 11, 2008, NYSE Euronext hosted a webinar addressing dark pools, the increasingly popular electronic trading venues that match orders quickly and anonymously without displaying them on an exchange. The participants on the panel were:

- Christine Sandler, senior vice president, NYSE Euronext, North American Sales
- Keith Gersten, head of Equity Trading, AllianceBernstein
- James G. Ross, vice president, NYSE Euronext, NYSE MatchPoint
- George Sofianos, vice president, Goldman Sachs, Equities

Background

NYSE Euronext's Christine Sandler—moderator of the discussion—asked the panelists for a definition of dark pools, hoping to “lift the veil” on what essentially remains a mystery to most people. Dark pools were described as electronic networks where buyers and sellers of securities are matched anonymously. They originated in the 1980s in response to large institutional investors who wanted to trade anonymously to prevent information about their orders from leaking into the market. Institutional investors—particularly mutual fund portfolio managers—also wanted to reduce transactions costs. The demand for anonymity, which traditional exchanges did not provide, gave rise to the earliest dark pools: electronic crossing networks, also known as electronic communications networks, or ECNs. Other types of dark pools or “dark liquidity” providers emerged, including broker consortiums and independent alternative trading systems or ATSS.

Today, there are an estimated 50 dark pools. Some of the biggest dark pools include Goldman Sachs Group's Sigma X, Credit Suisse's CrossFinder, Liquidnet and Investment Technology Group's POSIT.

Dark pools are referred to as “dark” because the trades executed in these anonymous electronic trading venues are not publicly displayed or advertised. George Sofianos of Goldman Sachs noted that “non-displayed” is a more accurate way to describe these trading venues.

Fragmentation of Liquidity: Growing Issue for Users of Dark Pools

While the proliferation of dark pools has increased competition and encouraged innovation, it has fragmented non-displayed liquidity, making it difficult for traders to fill block orders. James Ross of NYSE Euronext noted that only three of the 50 dark pools trade orders over 500,000 shares, a “real concern” for global institutional trading firms such as Keith Gersten's AllianceBernstein, which typically trades in order sizes that are 100 times larger than the average trade size.

Exchanges as Aggregators of Non-Displayed Liquidity

The fragmentation of non-displayed liquidity has led to a movement among exchanges and broker dealers to aggregate liquidity. One forum attendee, frustrated with the fragmentation of the market, asked the panelists how long it would take for the non-displayed market to consolidate. Estimates ranged from three to five years, with Ross saying that it could happen even sooner.

Both Ross and Gersten saw exchanges as best suited for aggregating liquidity. Exchanges are the only places with the capital and capacity

to trade all assets of securities on a standard platform at low cost with low latency 24 hours a day, said Gersten.

NYSE Euronext in the Dark Pool Arena

NYSE Euronext is pursuing a strategy to make it easier, faster and less expensive for customers to access liquidity. It is adding dark pools to the array of execution choices it offers customers and creating linkages between its traditional displayed liquidity and the new non-displayed liquidity. Among the initiatives are two new facilities for executing non-displayed orders that Ross described:

- NYSE MatchPoint, a new electronic exchange facility that will match aggregated orders at predetermined times with no market impact. The “anonymous order aggregation at fixed points in time,” explained Ross, “will help bridge the gap between displayed and dark liquidity.”
- A joint venture with the alternative trading system, BIDS Trading, to form New York Block Exchange. The New York Block Exchange will offer a continuous, non-displayed trading system to enable automatic block-order execution and negotiation.