

February 19, 2014 Virtual Café Chat Recap

"Dark Pools and Trading Trends in the Capital Markets"

The NIRI Virtual was delighted to recently host Nicole Olson for our February Café Chat where she applied her 10+ years experience in capital markets to provide commentary and to answer questions.

As IROs, we need a working knowledge of Dark Pools and how to navigate trading trends in the capital markets. Nicole has a unique perspective because of her market structure experience at Liquidnet, a dark pool where institutional clients can trade blocks of stock.

Nicole began the discussion defining dark pools and contrasting their characteristics with other exchanges such as NYSE and NASDAQ. Some of her highlights included:

- Dark pools do not provide pretrade transparency. This means there is no displayed order book -- unlike those that can be found on "lit" exchange such as NYSE and NASDAQ (e.g. bid, ask and size).
- Investor motivation for using a dark pool includes protecting information leakage ahead of completing a trade strategy in a stock.
- Every dark pool has a slightly different business model. Some are a place for large institutional investors to trade large blocks of stock, others are a venue for the sell side to trade smaller orders, etc. With the former, the benefit to these large investors is reduced volatility and market impact.
- Dark pools are regulated like any broker/dealer.
- Trading volume in a dark pool prints to the "third market" and is included in the official aggregate total of daily volume at end of the day.
- Volume traded in a dark pool will show the acronym of "ADF" which stands for Alternative Display Facility" as it prints.
- Approximately 50% of a stocks daily volume is traded in a dark pool. Actual percentage will vary depending on the characteristics of the stock (e.g. retail ownership, market capitalization, etc.)

Nicole highlighted that additional trading and volume disclosure requirements for dark pools are being discussed at the regulatory agencies. Current debate is around the merits of aggregated weekly trading disclosure within dark pools that would be 2-4 weeks delayed. Under this proposal, disclosures would contain the name of the broker/dealer that executed the transaction, as opposed to the current label of "ADF." Stay tuned for where that discussion goes.

For the remainder of the Cafe' Chat, Nicole answered questions from our participants and gave some practical tips on how to monitor trading trends in your stock. The Q&A is below.

Any relationship between high frequency trading (HFT) and dark pools?

- Not a lot of overlap between dark pools and HFT but depends on the dark pool's business model.
- Liquidnet does not support HFT and focuses on larger block trades. Liquidnet trade happens in seconds where as HFT happens in less than a second and as fast as possible.

- Depending on your stock, HFT can account for 30-40% of your daily volume. HFT can add liquidity to a stock and/or add volatility – ther merits of which can be debated.

Does Liquidnet actually take positions in stocks, or is the company just a match maker?

- Liquidnet does not hold any positions in a stock and is only a match maker.

Can a dark pool be used for a Company share buyback strategy?

- Yes they can be used to execute a stock buy back.
- Companies have another set of guidelines to follow during a share repurchase, which could make them more suseptible to market impact and volatility during the transactions..

Do you see more NYSE-listed companies traded or NASDAQ-listed companies?

- Exchange listing is really not a driver.
- Market capitalization more important.
- Tend to see more small and mid-cap stocks overall because of liquidity.

If liquidity is an issue for a stock, what things can I consider to increase?

- Number of news releases
- Option expirations
- Understand how comparable stocks trade and how your stock trades relative to those comps

Dark pool trading trends in U.S. versus Europe and other parts of the world?

- Today, trading is pretty consistent on a global basis.
- Dark pool trading began in the U.S. around 2000 because of technology innovations.
- Europe followed the U.S. a couple of years later and Asia after that.

How can you tell if a trade in your stock occurred in a dark pool?

- Will show the “ADF” designation.
- If a trade shows whole pennies that could mean it happened at bid or ask on an exchange.
- If a trade shows 3 decimal places in the price, it could signal a dark pool trade because it occurred at the mid-point of bid/ask.

Has Social Media had an impact on dark pools?

- Not much of an impact for Liquidnet because clients are typically long-only institutions.

The NIRI Virtual Chapter would like to thank Nicole Olson for her generous contribution of time and expertise. We hope that all the program participants found the Cafe’ Chat information useful and encourage all our members to dial in and participate in our future events.

NIRI Virtual Chapter

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