

CEPR-Imperial-Plato Inaugural Market Innovator (MI3) Conference

Evolving Market Structure in Europe and Beyond

29 June 2017

Overview

This document provides an overview of the key points covered during the research paper presentations and panel discussion the recent Plato Partnership Market Innovator (MI3) Conference, '*Evolving Market Structure in Europe and Beyond*'. Once approved, this document will be fully designed and distributed as a follow-up to attendees. This is in addition to following-up on our promise to post information and links to all the research papers to the Plato website.



Dark Pool Reference Price Latency Arbitrage, Peter O'Neill

Keypoints:

- Dark pools have an order book, but that order book doesn't determine prices, and there is a lot of reliance on reference prices.
- Race conditions on prices exist, where the new price is set against the market participants.
- The paper looked at whether reference price feeds still mattered in dark pool environments.
- There is an increasing awareness of the importance of robust feeds, but to a certain extent, feeds are always going to be stale.
- The paper looked at whether reference prices in a dark pool were a market design that ultimately harms liquidity.
- The research found that about 4% of trades could be considered 'stale', with a correlation between the volume of market traffic and the number of stale trades.
- The findings were that it was less an issue of 'price impact' and more 'mispricing', but nevertheless there was a detectable level of adverse selection.
- There have been proposals for market design solutions, one of the most successful being Plato's random uncross feature, which matches passive orders at random speeds between 5 and 45 seconds.
- Another option is NASDAQ's SIP upgrade, which cut processing speeds down from 500 microseconds to 40 microseconds.
- However, Plato's method reduces adverse selection, where NASDAQ's SIP upgrade doesn't as while lag may be reduced, HMTs remain left behind.
- Market design solutions go some way to removing market race conditions.
- Stale trades require a price change, and a re-run with price changes were not considered stale.
- People benefitting in dark pools tended to be the aggressors.



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Key questions:

“Was there any correlation between price changes in lit markets informing dark pool activity? Are they simply reference price gaming and creating the price changes for their own advantage?”

To shift outside the BDO would be very hard, and even then would only relate to a very small subset of trades.

“Is this activity driven more by market activity or deliberate attempts?”

A constraint of doing FCA research is that there is a limited scope to look at data from a market abuse viewpoint.

“Was it quantified that any profit was gained?”

The study only identified small levels of trading, approximately £4 million over the year, so there was not a significant amount of money on the table.

“Are you excited about the new data that will be available from MIFID II?”

Yes, but we are cautious, as it will be a large burden for the industry, and the data quality may be lower than expected, especially in the short term.
