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

Evolving Market Structure in Europe and Beyond

29 June 2017

Conference Overview

The inaugural Plato Partnership MI3 academic conference, Evolving Market Structure in Europe and Beyond, was held in conjunction with Imperial College London and the Centre for Economic and Policy Research (CEPR).

With over 80 attendees combining a balanced mix of industry practitioners and senior academics from across the globe, the discussions were informative, in-depth and varied. Seven papers, submitted by leading academics in advance of the day, were chosen for discussion by leading industry experts.

This document provides an easily-digestible summary of session 5, led by Carole Comerton-Forde, University of Melbourne.

Shedding light on dark trading in Europe, Keynote Speech by Carole Comerton-Forde, University of Melbourne

Background:

- There has been a large growth in venues and algorithmic trading.
- The buy side's primary directive is sourcing liquidity whilst minimising information leakage price impact.
- However, with more venues comes increasing complexity, and there are trade-offs between speed and information leakage.
- Traders want flexibility on a full spectrum of venues.
- Current regulatory concerns on dark trading focus on the lower levels of information revelation and the lower incentives to display liquidity if dark trades happen before lit and spreads widen.
- Too much dark trading has an impact on price discovery.
- Steps have been taken: Australia and Canada have put in place price improvement rules, and saw a large decline in dark volumes with a limited impact on market quality.
- The US has increased operational transparency and trade reporting requirements.
- Europe has narrowed the reference price waiver scope, with double volume caps for RPW, 4% for a single dark pool and 8% in aggregate across dark pools.
- BCNs are also to be abolished.
- Systematic Internalisations are becoming more onerous, with public quotes for liquid stocks, and quotes on request for illiquid firms.
- There will also be no client to client matches, only matches based on internal orders.

Impact:

- The impact of the RPWs aren't problematic, but the volume caps will have a significant affect.
- Rosenblatt found that the 8% limit was triggered on 74% of 757 stocks.
- A larger proportion of UK and Irish stocks were affected.
- 4% was less binding.
- The 8% cap was triggered for 83% of mid-caps, 67% of large caps.
- All algorithms will also be impacted, but it will be largest for dark algorithms.
- A significant fraction of parent orders were too small for Large in Scale waivers.
- BCs are unlikely to convert to MCNs as this will be too expensive and there is less reason to with no client to client matching.
- The importance of SIs will increase as they are allowed to trade in increments smaller than tick size, but will be limited to matching the internal flow.

Market Response

- There are likely to be more large-in-scale venues (Plato, BATS, LIS).
- These will complement existing block venues, with block venues market share growing rapidly.
- There will also be capacity for venues offering larger minimum execution sizes and achieving larger average trade sizes.
- There are likely to be new and modified LIS order types.

Challenges

- There is a risk there will be a proliferation of new venues, and with block liquidity split, there will be a lower probability of execution, and it will be harder to find block liquidity.
- It will be harder to manage optimal resting times against the order anticipation risk.
- It will be harder to measure block execution quality.

Looking forward

- More research should be done to assess how waivers can be used most effectively to avoid caps.
- There should also be a drive from market participants for a deep dive on new venue and order types, particularly on how to use their new functionality and measuring execution performance, as well as a deeper understanding of algorithms and SOR.