

Clarity needed on dark pool volumes

An industry-wide method for calculating trades is needed, writes Melanie Wold

The methodology used by non-exchange dark pools to calculate and advertise their volumes may be contributing to an over-hyping of the industry, according to analysts.

While there are guidelines for reporting matched volumes via a designated trade reporting facility, there is no standard way of calculating them. The result could be an exaggeration of market share leading to confusion for the buy-side.

Most sellside broker-dealers' and independent dark pools count a matched trade twice – the buyer's volume and the seller's volume. This is historically how broker-dealers would count customer-executed volume. The problem comes when smart-order routing is added to the equation; many sellside broker dealers and independent pools count the volume routed out as well.

If a sellside broker sends an order to its own dark pool, and some of it is matched and some is routed to another dark pool, that broker could be counting the volume two or three times. When it gets matched in the other dark pool, it is counted again – once or twice. This means that advertised volumes can be several times that which is actually matched within the pools.

Whit Conary, president of trading system Level ATS, said: "Double counting is one thing, but what I don't think dark pools should do is count routed volume. There are

venues that triple- or quadruple-count volume."

Two companies produce monthly reports for their clients in which they have to slice, calculate and adjust volumes from dark pools that release figures to make them consistent. Consultancy Tabb Group does a monthly liquidity matrix, and agency brokerage Rosenblatt Securities produces a monthly dark liquidity tracker.

Most of the dark pools use double counting as normal practice for marketing purposes. Dark pool Bids chief executive Tim Mahoney said it went back to the 1980s to Nasdaq before it became an exchange. He said Bids uses both sides of a deal because it gets paid for both sides, but only the actual matched amount gets reported to the trade reporting facility.

Exchanges only report the actual volume executed, or a single count. Colin Clark, vice-president of strategic initiatives at NYSE Euronext, said the dark pools tend to advertise the volume on both sides and might include routed orders. "Obviously they want to show the biggest amount."

NYSE Euronext discloses matched volume on the exchange on a single-count basis, meaning one side only, not double counting both sides. Routed volume is disclosed separately, said Clark.

Mahoney said: "The issue is that exchanges clearly single-count but almost everyone away from them double-counts. You cannot compare. I am not sure either way is wrong; I could agree with both sides."

Morgan Stanley, which has just signed bilateral deals with Goldman Sachs and UBS to make each others' pool accessible to the others, doesn't agree; it wants to see more standardisation.

Andrew Silverman, head of distribution for Morgan Stanley Electronic Trading, said dark pool volumes had been exaggerated because of double-, triple- and even quadruple-counting. He is calling for the methodology to be standardised: "I would like to level the playing field. Our message is that it is the buy-side's order flow and they deserve transparency. Right now they don't have the necessary information to compare apples to apples."

Some pools choose not to publish figures at all because of the inconsistencies. Merrill Lynch has historically chosen not to publish these numbers because there is no industry-wide protocol for calculating crossed volumes, said Jarrod Yuster, head of global electronic and portfolio trading at Merrill Lynch. Yuster said that his bank instead provided customers with details of where their orders are executed, and how well, including within dark venues.

Tabb Group's monthly liquidity matrix includes exchanges, electronic communications networks, dark pools and crossing networks. It distinguishes between volume that "passes through" and that which is matched in dark venues. Cheyenne Morgan, research analyst at Tabb Group, said the company was in the process of figuring out how to make the "apples-to-apples comparisons".

"There are many ways to count the volume numbers. The method we are trying to utilise is where we separate 'matched', 'routed and eligible for matching', 'routed and not eligible for matching' and 'touched'," said Morgan.

The dark pool hype may be taking focus away from the exchanges where the majority of non-displayed volume takes place. Exchanges look like the unsung heroes in the dark liquidity game. Silverman said: "Exchange pools, with the iceberg and reserve orders, have been overlooked."

Rosenblatt's April monthly dark liquidity tracker newsletter estimated that 6.64% of consolidated volume was executed by 18 major non-displayed markets. This did not include dark order types within displayed markets such as Bats Trading, Nasdaq OMX and NYSE Arca. This comprises another 10%-20% of total US consolidated volume, said Gawronski.

In April, Nasdaq executed 353 million shares per day through dark order types, or 17.7% of Nasdaq's total US volume, said Brian Hyndman, senior vice-president of Nasdaq transaction services. "We have the ability to break out our non-displayed liquidity from our displayed liquidity. We are the largest exchange in terms of volume in the US and the largest for non-displayed volume."

NYSE Euronext does not provide granular volume details because non-displayed orders can interact with displayed orders, but said that the volume is substantial. "Non-displayed order execution is significant and increasingly popular. We offer rebates for non-displayed liquidity and offer better fill rates [than independent dark pools], as well as the benefits of anonymity and price improvement potential," said Clark.

Clark said exchanges were also acting as re-aggregators of liquidity in the marketplace, linking with and routing to other dark pools as well as other exchanges. NYSE Arca routes to more than 30 destinations, said Clark. Routed volume is not counted as matched volume on the exchange.

Conary said: "Customers go where the volume is. They should count only what is executed within their system."

On the other hand, he isn't ready to give up double-counting: "We can't single count if everyone else double counts. But we'd agree if that were the standard."