

# “Dark Pool Exclusivity Matters” by Boni, Brown, and Leach

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# Background

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- Increase in market fragmentation post Reg NMS
  - More alternative trading venues, e.g. dark pools
  
- Mixed evidence on how fragmentation affects market quality (e.g. O'Hara and Ye (2011) , Weaver (2011))
  
- Evidence of dark pool heterogeneity (Butler 2007)
  - Implications for execution quality?

## Boni, Brown and Leach (2012)

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- Examine a possible link between dark pool exclusivity and execution quality
  - Exclusivity: Liquidnet Classic focuses on buy-side institutional investors
- Hypotheses: More exclusive venues should exhibit
  1. lower serial correlation in returns around large trades
  2. less volume increases prior to a large trade
  3. less volatility increases prior to a large trade
  4. higher follow-on volume in large trades ('clustering')
- Compare Liquidnet, Open Access trades, and Other Dark Pools

## Findings confirm hypotheses

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	Open Access Trades	Liquidnet	Other Dark Pool Trades
1. Pre- and post-trade return correlation	–	0	–
2. Pre-trade volume increase	+	0	+
3. Pre-trade volatility increase	0	0	+

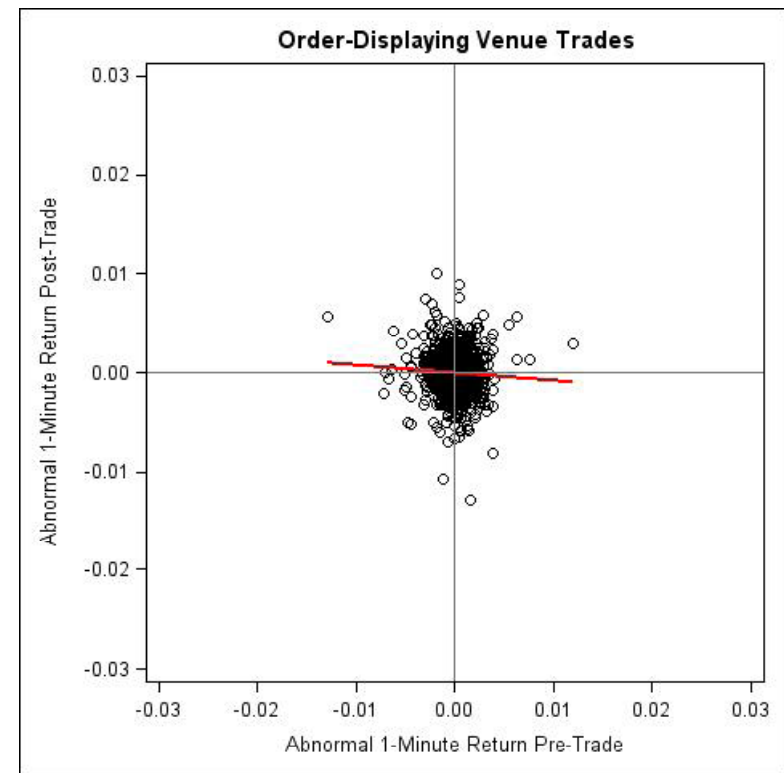
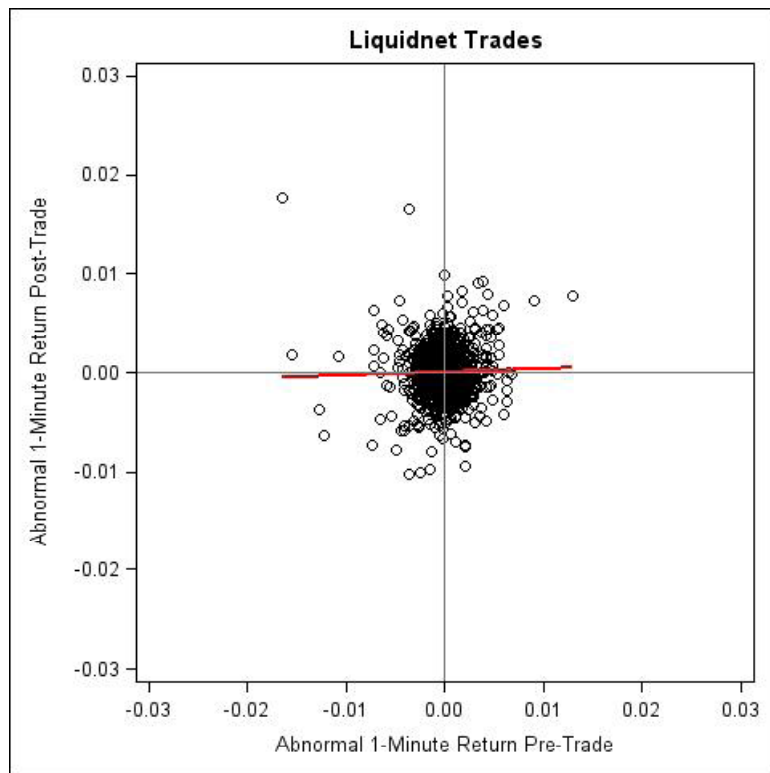
4. Clustering of trades: At Liquidnet, lagged block trades predict future block trades to a larger degree than at other venues

## Discussion & Suggestions

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- Tighten motivation; explain link to fairness
- In addition to return correlation, volatility and volume, could transaction costs (approximated by spreads) be used as a measure of execution quality?
- Complement nonparametric tests with parametric results.
  - At least include point estimates of the correlation, volume, and volatility differences and comment on economic significance (example on next slide)

# Example: Abnormal Return Autocorrelation



## Discussion & Suggestions ctd.

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- How reasonable is ‘ceteris paribus’ assumption?
- Motivate the clustering channel
- How general are the results?
- If no data on other exclusive pools are available, consider:
  - Ranking the trading venue by exclusivity:
    - Liquidnet, Other Dark Pools, Open Access Trades
  - Showing that measures of market quality generally deteriorate as move to less exclusive venues

	Liquidnet	Other Dark Pool Trades	Open Access Trades
Pre-trade volume increase	0	medium	large

# Conclusion

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- Overall, a very interesting and topical paper
- Execution quality may be improved at Liquidnet, because it restricts its population of participants
  - More nuanced language is needed for dark pools