

Fifty shades of lights in Dark Pools

new regulations



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Glossary

Al.	paragraph;
APA	Approved Publication Arrangements;
ARM	Approved Reporting Mechanisms;
Art.	Article;
ATS	Alternative trading system;
BCN	Broker-dealer Crossing Network;
CCP	Central counterparty.
Cf.	see;
CHF	Swiss francs;
CO	Swiss federal Obligation code, RS 220;
CTP	Consolidated Tape Provider;
Ed.	Editor;
e.g.	For instance;
EEOTC	Economically Equivalent OTC;
EMIR	Regulation EMIR (EU) No 648/2012;
ESMA	European Supervisory Market Authority;
ETF	Exchange traded fund;
EU	European Union;
f.	And following;
ff.	And followings;
FINMA	Swiss Financial Market supervisory Authority;
FINRA	Financial Industry Regulatory Authority;
FMIA	Financial market infrastructure act, RS 958.1;
G20	Group of the twentieth;
HFT	High-frequency-trading;
MDP	Multilateral Dealer Platform;
MIFID II	Markets in Financial Instruments Directive 2014/65/EU;
MIFIR	Markets in Financial Instruments Regulation (EU) No 600/2014;

NBBO	National best bid offer;
NCA	National competent authority;
OMIA	Ordinance on market infrastructure Act, RS 958.111;
OTC	Over-The-Counter;
OTF	Organized trading facilities
p.	page;
pp.	pages;
RM	Regulated markets;
RS	Swiss Systematic compilation;
SDP	Single Dealer Platform;
SEC	Securities and Exchange Commission;
SESTA	Federal Act on Stock Exchanges and Securities Trading, RS 954.1;
SESTO	Ordinance of the FINMA on Stock Exchanges and Securities Trading, RS 954.193;
SI	Systematic Internalizer;
SIFI	Systematic Important Financial Infrastructure;
U.S.	United States of America;
U.S.A.	see U.S.

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Introduction

Private trading venues or Over-The-Counter (OTC) are often pictured as mysterious and harmful, however, they are nothing but a recent and natural evolution of today's market that is growing decentralized and overregulated. Indeed, overwhelming financial regulation has given reasons to market participants for exploiting loopholes. Further, private venues' initial *ratione* are legitimate. They were first created to help fixing inefficiencies of the markets, as the adverse selection when large block is traded. In this regard, one can consider Dark Pool as fulfilling a useful complementary role next to the exchanges *stricto sensu* or Regulated Markets (RM).

The meaning of traditional exchanges has drastically changed in those last 25 years towards more digitalisation, decentralisation and complexity. During this 25 years' time period, the market was left in part auto-regulated and out of the scope and preoccupations of Regulators. However, after the 2007-8 crisis, this situation was about to change. Political Authorities realised that markets had evolved beyond their understanding and it could become wild: Times for new regulation had come. As a consequence, we recently saw a true "*tsunami of regulation*" in Europe aiming in its vision's scope notably the OTC markets, which is our topic here¹.

Today, as said, the regulation of OTC is currently growing since the call of the G20. The regulation is motivated, by the fact OTC has gained a significant influence over the trading of securities. Indeed, Investors have found in private exchange platforms, as dark pool², a valuable and efficient alternative to traditional liquidity providers. The literature uses the term "*dark liquidity*" to name the off-exchanges liquidity sources.

In the present work, we will focus on the phenomenon of Dark Pools that is part of this dark liquidity providing or OTC. We will study the reasons why markets participants are attracted to it and see how worldwide Regulators intend to legislate about it.

In the first part of this work, we give a general overview of today's financial environment on the securities markets and the volume of OTC on it. Then we set the definition of a Dark Pool (*infra* n°1). In the second part, we will assess the recent regulatory changes in Switzerland and

¹ MÜLBERT, p.369 ff.

² Or for instance Crowdequity platforms.

in the European Union regarding Dark Pools with a few words also regarding the situation in the U.S. (*infra* n°2). Finally, we will sum up and dress a general conclusion.

1 The financial environment

1.1 Market ecosystem

In preamble, we address here some general remarks regarding today's markets. First, is that whichever market you look³ (U.S., Europe, Asia), Regulators face **fragmented electronic markets** with strong international (cross-border) connection and dependencies⁴ whilst being nationally regulated. To illustrate this point, we can notice that in Switzerland SIX stock Exchanges (RM), the predominant exchange in Switzerland, releases its own rules⁵ and handles cross-border trades derivatives representing 87% of the OTC trades (which differs largely with the U.S. for instance (around 10%))⁶.

Second point to mention is that among the trading facilities' ecosystem, Regulated Markets (RM) and Over-the-Counter markets (OTC⁷ or ATS in the U.S.) are in **competition** with one another⁸. This competition is exacerbated by the fact that they both trigger significantly different legal regimes. Nevertheless, we note they represent two faces of the same coin since they are both part of the market infrastructure permitting the trading of same or equivalent instruments. This competition aspect highlights also that one should however not consider one (notably OTC) as being solely a way to legally escape regulation of the other (RM).

Last point, we note that if trading of Securities (equity, bond and derivatives) was taken place historically on RM, Investors have shown those last 10 years a **net appetite for OTC**⁹. In order to give the reader an idea, some authors estimate that equities are traded for 40% off-exchanges in the U.S (Hence ~12% in Dark Pool)¹⁰. In the EU, the numbers turn around 50%

³ Except North Korea maybe.

⁴ N.b. It is very difficult to assess a worldwide situation of the Markets, since each country can have multiple markets and is regulated mostly by national law and the specific markets rules. Further, the types of instruments and the designs has a huge influence.

⁵ Hence creating its singular market design.

⁶ FMIA report, p.122 f.

⁷ Defined under art.19(6) MIFID II.

⁸ HOCHSTRASSER, p.305.

⁹ <http://www.bloomberg.com/news/articles/2016-01-14/european-dark-pools-expand-in-face-of-rules-limiting-their-use>. In this regard, we may mention another recent phenomenon providing “dark liquidity” that is crowdequity. It is currently disrupting the traditional stock exchanges process to fund companies.

¹⁰ <http://cnb.cx/1NwPyIq>; HOCHSTRASSER, p.308.

for the off-exchange¹¹, (Hence ~9% in Dark Pool)¹². We note that those numbers vary according to definition given to Dark Pools. In values, the OTC market represented 633'000 billions \$ in 2012 where 90'000 were traded in Switzerland only¹³.

1.2 Dark pools

Dark Pools **history begins** in the early 1980¹⁴ but became a topic of controversy only after the 2007 crisis, which they did not cause. In Europe, the phenomenon is more recent than in the U.S. Among the reasons why it appeared, one can mention: the loophole created in the regulations (MIFID I or RegNMS), new technologies like HFT and the necessity for some actors to protect from their predatory techniques, the possibility to obtain a better price for large order or even the fees less important on private venues than on RM. It is acknowledged that all those elements have increased the interest for Dark Pools¹⁵.

First, let's give a definition. A **Dark Pool** can be basically define as a electronic private trading platforms through, which orders can be sent anonymously and where bid and offer are not displayed to the public (no pre-trade transparency)¹⁶. However, we mention that a unique and homogeneous definition is still missing¹⁷, notably because different types of markets and designs induce different definition¹⁸. Further, Dark pools are exploited either by Broker-dealer (SDP), RM or market-makers (MDP)¹⁹ but most often Dark Pool, in Europe at least, are exploited under the form of a MTF²⁰ (but it can also be under the form of a SI or a BCN (OTF)²¹. In the other side, U.S. regulation defines it simply as a type of ATS. The general predominant characteristics of Dark Pools are: the trades occur anonymously, the volume of trades are large, and no pre- / few post-trade transparency exists.

On a worldwide scale, the two leading Swiss Banks (Credit Suisse and UBS), both part of the G16 dealers, rule the two biggest (way above) dark pools in the U.S. (around 40 Dark Pool in

¹¹ ZIMMERMANN, 103 f.

¹² <http://regtechfs.com/mind-the-cap-dark-trading-under-mifid-ii/> ; HOCHSTRASSER, p.308.

¹³ FMIA report, p.122.

¹⁴ HOCHSTRASSER, p.307, If not before.

¹⁵ BIEDERMANN, p.81.

¹⁶ *Idem.*

¹⁷ BAISCH/BAUMANN/WEBER, p.188.

¹⁸ *Idem.*

¹⁹ <http://www.investopedia.com/articles/markets/050614/introduction-dark-pools.asp>; EASTHOPE / RAY, p.6.

²⁰ EASTHOPE / RAY, p.9 f.

²¹ According to the new regulation the BCN will be equivalent to the OTF.

the U.S.)²². To give an order of idea, Credit Suisse U.S. Dark Pool alone (named CrossFinder) contributes to the exchange of 374 millions stocks per week in 2014²³.

It is important now to shortly summarize the **pros and cons** regarding of Dark Pools from an economical point of view since it influences the legal *ratione* of the recent regulations.

On the one side, Dark Pool's initial reason to exist is to create (non-toxic) liquidity by helping Wholesale Investors (e.g. Hedge fund, pension, fund,...) when they trade large orders (so-called "*Iceberg*"). The fact that no pre-trade transparency applies enables Investors not to suffer an adverse price selection. This adverse price selection could be exploited by HFTs spotting the orders with ease on on-exchanges using sniffing algorithms and predatory technics to earn money and create a supplementary burden on transactions²⁴. Another advantages would be then the diminishing of competition between participants²⁵.

On the other side, Dark Pools' mechanisms are "*dark*", not transparent to Investors or Regulators. This lack of essential data can undermine market quality²⁶, notably with regard to price formation and discovery (even though price are often fixed in reference to the RM's quote²⁷). As a consequence, Investors, might not always get a proper evaluation of the risks or the best deals when trading, which contradicts notably the best execution rule under art.27 MIFID II or the U.S. National Best Bidder Offer (NBBO)²⁸. Furthermore, the public quote of assets may be considered as biased by the public.

The opinion that Dark Pool occupy a legitimate place on today's markets according to their helping role regarding wholesale Investors has been weakened lately. Indeed, recent studies have shown a shrinkage of orders size²⁹, which diminishes the initial and principal *ratione* for keeping pre-trade transparency advantageous exceptions for Dark pools. Nonetheless, we note that the real effects of those transparency requirements are abundantly discussed and still under experimentation³⁰.

²² YESHA, p.4.

²³ <http://bit.ly/1qfis8w>

²⁴ As it is not dependent of the share price on the stock market.

²⁵ BAISH / BAUMANN / WEBER, p.182 f.

²⁶ JAROSLAW / HENKER / HENKER, p.1.

²⁷ BAISCH/BAUMANN/WEBER, p.188.

²⁸ <http://www.investopedia.com/terms/n/nbbo.asp>

²⁹ <http://www.bestexecution.net/analysis-dark-pools-best-execution/>; Appendix Average size per trade.

³⁰ FOLEY / PUTNIN, p.1.

Lastly, another endarkening element, is the high speed of execution and market complexity. Those reduce the chances to catch dishonest traders³¹ and statistically augments the possibilities of market abuses (e.g. Insider dealing). Although the proof of misconducts are very hard to detect, the jurisprudence has given several cases (mostly displayed by the SEC)³². The two most repeated constellation is the selling of (non-public information) to HFTs in order to commit front-run³³ but also the non-objective (or only partial) displaying of the Platform's mechanisms. In 2016, the biggest fine ever (150 million\$) was paid by Credit Suisse for this last ground in the U.S.³⁴.

Finally, we mention the default risk of the counterparty, which gave birth to the whole CCP requirements and clearing obligations for OTC (standardized contracts or not) under the recent EU regulation³⁵.

2 Regulations of Dark pool

In the following subsections, we will observe an overview of how worldwide Regulators intend to regulate Dark Pools. As a general preamble, we may say that the *ratione behind those regulations* are multiple, we can mention the followings: First, the Regulators responded to a political demand being to get back in control over markets, to recover stability and to sanction Financial actors for the crisis. Second, they wished to diminish the attractiveness of "dark trade", as Dark pool, by setting them back on an equitable regulatory foot with RM. Thirdly, because investors protection may be at risks with regards best execution and transparency. Finally, Regulators wished to overcome the new complexity of the global markets by understanding its functioning and stating transparency as a rule by default.

2.1 Switzerland

In Switzerland, a new legal regime has entered into force on the 1st of January 2016. The **Financial Market Infrastructure Act** (FMIA) was adopted to unify the current legislation³⁶ and to make it compatible with international standards (notably G20 regarding OTC). The

³¹JACCARD, p.41 ff. (51).

³² E.g. for instance <http://1.usa.gov/1NTtLwH> ; <http://bloom.bg/1KaOp7U>

³³ JACCARD, p.11. Note that the victim can sue by means of contractual and extra-contractual claims.

³⁴ <https://www.sec.gov/news/pressrelease/2016-16.html>

³⁵ (FMIA report p.9 f.). This last point triggered a large reform under MIFID II and notably the creation of the statute of Central Counter Party (CCP).

³⁶ This law partially abrogates the SESTA/SESTO, the NBA and the BA. See OIMA report, p.2. .

FMIA follows a euro-like approach regarding the (also new) European regulation MIFID II³⁷. This compatibility test is vital since in the hypothesis the materiality of the law was differing, Swiss actors would not be allowed on European markets anymore, which is inconceivable.

First element, the FMIA replaces the distinction between the generic terms “*exchanges*” and “*exchanges-like*” platforms³⁸ by creating a **new categorisation**: “*Trading venues*” (art.42 FMIA). They are considered as “*Infrastructure of the Market*” and divided into three types: Regulated markets (RM), Multilateral Trading Facilities (MTF), Organised Trading Fund (OTF) only when it enables multilateral negotiation³⁹. Additionally, others participants exist, as Systematic Internalizer (SI), which represents an important part of the dark liquidity. Note, the OTF was conceived as a subsidiary type for whichever platforms that is not either a RM or a MTF and to encompass Broker Crossing Network (BCN). Lastly, similarly with the EU, the FMIA foresees that trading of securities must (art.28 al.1 MIFIR) now only take place on those regulated trading platforms, which reduces the ability for actors to escape regulation. In facts, the FINMA will keep a large power of appreciation to decide whether an actor fall under those categories or not⁴⁰. Generally speaking, FINMA’s intention and moto is to keep a “*neutral approach*” regarding new technologies⁴¹.

As a consequence, previously excluded from regulatory scope, Dark pools will now generally fall under the definition either as a MTF, OTF (Infrastructure) or a SI. It implies they need to comply with new requirements. The first one being that they require an **authorisation** to practice (art.3 al.1 FMIA) as an investment firm. Second, they fall under **capital requirements**⁴², which represents 1 million CHF (art.13 al.1 OMIA). Further, they may need to find a **surveillance authority** adapted to their activities (Art.27 FMIA) in order to assume its auto-regulation competences⁴³. With this regards, we note that (unlike in the EU) an important **auto-regulation** room is preserved (art.26 FMIA) and Dark Pools will be able to produce their own rule in application of the FMIA. At the level of the negotiation, the platforms must comply with the obligation to conduct an “*equitable, ordinated and*

³⁷ FMIA report, p.14; HOCHSTRASSER, p.308 f.

³⁸ (*Börsen ähnliche handelsystem*)

³⁹ If OTF takes place only in a bilateral constellation, then it does not fall under the FMIA and is not considered as an Infrastructure. The condition of multilaterality, were not concerned since, according to the legislators, the did not risk to harm the good functioning of the market (see FMIA report, p.31 and art.3 al.2 FMIA).

⁴⁰ FMIA report, p.13.

⁴¹ <https://www.finma.ch/fr/autorisation/fintech/>

⁴² FMIA report, p.129.

⁴³ OMIA report, p.14.

*efficient*⁴⁴ organisation. Last but not least, new pre-trade and post-trade disclosure requirements (transparency) will be studied underneath (*infra* n°2.2) since they are similar to EU regulation (art.29 FMIA and 27 f. OMIA).

Finally, the FMIA sets general requirements concerning Dark Pools *a fortiori*. For instance, the art.19 FMIA (respectively art.37 FMIA) foresees that operators of Dark Pools will be required to **prevent conflict of interest** with their clients, which was particularly at danger whenever the venue sells or gives data to a HFTr or to its own affiliate or subsidiary. Unlike in MiFID II, this obligation will not disable operators to use their own Dark Pool platform to conduct proprietary trading⁴⁵, with exceptions⁴⁶. Further, the art.17 FMIA sets that platforms operators will be required to define clearly its **contractual relationships**. Indeed, as the relationships is not-standardized⁴⁷, the general rules regarding the Swiss Code of Obligations apply. We note though that pseudo-official models of contracts exist, as the “*contract for OTC relationships*” set by the Swiss banking Association⁴⁸.

2.2 European Union

A. General

In Europe (also), a new legal regime has been adopted it will enters into application on the 3rd of January 2018⁴⁹. This regulation called **MIFID II / MIFIR and EMIR** (level 1 regulation) is a “*cornerstone*” regulation for the European market that will harmonise the European regime and create a level playing field over a single area: Europe.

The legislation will also introduce the **same three types of trading venues** as seen above (*supra* n°2.1) as market infrastructures (RM, MTF and OTF). The key differences between the three European venues are pictured in the annex⁵⁰. In consequence, Dark Pools will now be categorized either a MTF/OTF or else (e.g. SI).

B. Pre-trade and Post-trade transparency

⁴⁴ Cf. art.36 FMIA.

⁴⁵ FMIA report, p.19 and p.25.

⁴⁶ For instance, illiquid sovereign debts instruments and see list under art.5 EMIR.

⁴⁷ FMIA report, p.12.

⁴⁸ Contrat-cadre de l'Association suisse des banquiers pour les dérivés hors bourse (OTC), see also Contrat-cadre de l'International Swaps & Derivatives Association (ISDA).

⁴⁹ http://europa.eu/rapid/press-release_IP-16-265_fr.htm It was delayed from 2017 to 2018 recently.

⁵⁰ See *infra* Key differences.

The major step regarding the situation in Europe for Dark pool is the instauration of new transparency requirements that enable a **better access and fluidity of data** between markets participants and Supervisory Authorities (NCA or EU supervisor). This will help fixing the asymmetry of information between market participant, but also enable supervisors to detect risky position of markets participants⁵¹. A significant novelty is the extension of the scope from equity instruments to equity-like (e.g. bonds) and also non-equity instruments⁵².

In order to obtain disclosure of Market data, the new regulation institutes **pre-trade and post-trade transparency** requirements to be submitted on a continuous basis. It consists in disclosing trade information available “*on a separate and reasonable commercial basis*” (art.12 and art.13 MIFIR). Those trading information relates the price, volume, time and binding expression of trade (buy/sell). The requirements are substantially the same between the three new types of platforms (RM/MTF/OTF)⁵³, the difference of regimes being made considering what types of assets is dealt with: on the one side equity and equity-like products (e.g. ETF) and on the other non-equity, which hence triggers different transparency requirements⁵⁴.

In the following paragraphs, we will study the requirements of a trading venue (e.g. a MTF Dark Pool) dealing with equity and equity-like assets (art.3 ff. MIFIR) and highlight the functioning and exceptions regimes. We note that in case of non-equity trading (art.8 ff MIFIR) or of an Investment firm or even a SI exploiting a Dark Pool, the regime is slightly different (art.14 ff. MIFIR)

First, as a default rule, the regulation sets a **pre-trade transparency** that requires Platforms to publish public current bid and offer prices and the depth of trading interests at the price advertised through their systems on an ongoing basis during normal trading hours. It will be calibrated for different types of trading systems including order-book, quote-driven, hybrid, and periodic auction trading systems

However, the regime foresees exceptions under the form of a **waiver, notably for large orders** on average (4 al.1 let.c MIFIR ; 29FMIA, 27 al.4 OMIA)⁵⁵. The “*Iceberg orders*” waiver rule, prevent trading venue to disclose information that could lead to adverse price

⁵¹ FMIA report, p.9.

⁵² FRESHFIELDS / BRUCKHAUS / DERINGER, p.1.

⁵³ FMIA report, p.21.

⁵⁴ VON HALL, p.501.

⁵⁵ Others examples: Reference Price Waiver, Negotiated Trade Waiver, Order Management Facility Waiver.

selection⁵⁶ and guarantee the conservation of the initial *ratione* of Dark pool regarding wholesale Investors mentioned above. We note that this notion of “*large*” is not yet defined, but will be under ESMA’s technical standards. Further, we note it will be calibrated differently by class of equity and the reference price waiver will be established at midpoint between current bid and offer (stricter).

The above mentioned waiver is however not unlimited. As an exception to the waiver’s exceptions, the regulation conceived a **double cap volume**, which is basically a limitation for Market participants to trade away RM when the instrument is liquid on the market. The volume cap introduce hence a limit on the use of reference price and negotiated trade waivers of 4% per venue in a particular instruments of total trading in that instrument⁵⁷ (on all trading venue in EU) and maximum 8% in overall per instrument for the whole Europe. The calculation will be made on a rolling basis for the previous year, and twice a month. And the data will be collected from trading venue and CTPs. A warning will be send when the participants reach 0.25% before the limits (art.5 al.5 MIFIR)⁵⁸. Finally, in case of reaching of the limit, the trading venue shall suspend its use of the waiver on the venue regarding the specific instruments for a period of six months⁵⁹.

Secondly, once an order has been fulfilled, all trading venues will be require to apply **post-trade transparency**⁶⁰. It will be asked to display the price, volume and time of transactions as close to real-time as technically possible (“*immediately*” under 29 FMIA). ESMA has precised that the maximum laps of time it could represents was three minutes⁶¹. However, here also, the regulation foresees the possibility of discrepancy in time via a deferred publication (art.7 al.1 MIFIR; 28 al.4 OMIA). In the same vein, we can note that the **best execution rule foresees post-trade transparency** since trading venue will be required to publish data relating to execution quality.

Thirdly, we may note also the post-trade requirements sets under EMIR to CCP or trade repository for instance, to report all OTC trade for all derivatives contracts. This will create another channel of data. The information to provide will be, as stated above, data on the transaction but also information on clearing and on-going valuation for instance.

⁵⁶ VON HALL, p.501.

⁵⁷ Note, illiquid equity (And equity-like) instruments are not included.

⁵⁸ BAISH / BAUMANN / WEBER, p.191.

⁵⁹ FRESHFIELDS / BRUCKHAUS / DERINGER, p.4.

⁶⁰ HOCHSTRASSER, p.312.

⁶¹ FRESHFIELDS / BRUCKHAUS / DERINGER, p.6.

Fourthly, and lastly regarding data, as a further data displaying tool, the data may be subject to **consolidation** under an unified format and different Actors might be obliged to report respectively either to: Approved Publication Arrangements (APAs), Approved Reporting Mechanisms (ARMs) or Consolidated Tape Providers (CTPs)⁶². The goals are similar for the three above mentioned channel (except): disseminate to the public under the best condition the markets data and to ameliorate the synchronized access to data. Interestingly enough SI and other OTC are included in the Actors obliged to report. Finally, we may note that the consolidate tape (art.65 MIFID II) becomes the general channel of information sending under an unified format, close to real time and continuously data in relation to all types of instruments relating to trading on trading venue and by investment firms.

2.3 United State of America

In the U.S. the regulation of Dark Pools (ATS) falls under the Regulation NMS and Regulation ATS, which regime is much lighter than for classical Exchanges⁶³ (equivalent to RM). The activity is monitored by the SEC and the FINRA⁶⁴.

U.S. and EU regulation (RegNMS and MIFID II) do however generally follow the same goals with divergences on details⁶⁵. For instance, as in Europe, Dark Pools are also required to register and obtain authorization either as an exchange or as a Broker-Dealer to the FINRA. For the rest, Dark Pool fall under the same general requirements as any other participant. Nevertheless, the two approaches are different. In the U.S. the Authorities consider Dark Pool either as a RM or as an ATS whilst in the EU the reflexion now distinguishes different types of platforms (notably MTF and OTF⁶⁶) or else. In consequence, the requirements are less stringent in the U.S. since less precision in the categorization is made. For instance, ATS are not subject to guarantee a fair access to markets participants, as do exchanges.

The data transparency regime also exists. At the pre-trade level, the RegATS foresees that the trade must be report whenever it exceeds 5% of the average daily trading volume of a single stock (so a public-listed equity), which is not common (CrossFinder did 1.88% in 2016)⁶⁷. Interestingly, some American experts argue that Dark Pools may qualify as SIFIs and should

⁶² <http://www.nortonrosefulbright.com/knowledge/publications/115289/mifid-ii-mifir-series#autofootnote2>

⁶³ YESHA, p.31.

⁶⁴ MERCURIO, p.69.

⁶⁵ KERN, p.295 ; FERRARINI, p.12.

⁶⁶ In the U.S. there is no distinction made between a bilateral and multilateral platform.

⁶⁷ BAISH / BAUMANN / WEBER.

be specially regulated for this reason. In reaction, recently, a (first) proposal of reform to lower the transparency threshold to 0.25% was proposed to enhance transparency. Further, a second proposal to introduce a “*trade at*” rule, which consists in mandating that a stock traded in a Dark Pool must be sold for a price that is better than or equal to the price listed on the public market⁶⁸ was also proposed. The effect of the trade at rule would result in fewer orders being executed on Dark Pools and a regain of interest for traditional exchanges⁶⁹.

Regarding post-trade transparency, FINRA publishes ATS information (post-trade) immediately after they have been reported to them⁷⁰ and a consolidate tape exists as well with data analytics tools (as MIDAS)⁷¹. ATS must then also report to the FINRA the trade, however there can be delayed from 2-4 weeks after trade was concluded, which is incompatible with today’s speed of execution of the markets.

In definitive, the U.S. system is still very different than in EU. The access to the data is hampered and requirements are becoming less stringent than what the EU regulation foresees.

⁶⁸ MERCURIO, p.73.

⁶⁹ <http://www.reuters.com/article/sec-test-ticks-size-idUSL1N0XX3VW20150506>

⁷⁰ <http://www.finra.org/industry/otc-transparency>

⁷¹ PRICE&WATERHOUSE&COOPERS, p.6.

Conclusion

In this work, we assess some parts of the Swiss and EU new regime that will lightened and importantly impact Dark Pools exploiters. Among the novelties, the first interesting things is that regulations tends to redefine the definition of markets and the necessary scope of its action as not only including the exchanges *stricto sensu* (RM) but also the exchanges *lato sensu* (OTC). This reasoning seems fair to us since “*same business should induce the same rules*”⁷².

The worldwide regulations highlight the crucial values and importance that is market data in today’s complex environment. The pre-trade / post-trade transparency requirements will enable to understand the part of the trading evolving in the shadow along in maintaining the first economical *ratione* of Dark Pools not to pre-disclose (or deferred the disclosure) of large sized orders. Further, the EU double volume cap will will drastically limit and contribute to diminish the current attractiveness and affluence towards private exchanges.

Nevertheless, even though a waiver for large orders is conserved in order to restrain adverse price selection, we may still feel concern regarding the probable liquidity depreciation due to the harm done to Dark Pools via the overall volume cap of 8%. Furthermore, we believe this action to limit the volume of Dark Pool by law is extremely violent. In addition, even though those transparency changes are inherently positive, we can doubt that Supervisors will be able to handle such a massive collection of data. We believe that even in possession of the data, the processing and understanding of such rapid and complex environment that are today’s market relies either on a political move or a Sisyphé’s challenge: in both hypothesis it is an illusion of control.

In conclusion, an OTC regulation reform was certainly necessary considering the recent and fast amplitude this market took. However, the Regulators might have created a monster of regulation hardly understandable and very heavy to apply for markets participants, which can burden the economy. Finally, if the system appeared to be unsatisfactory, there are no reasons to believe new loopholes will not appear in order to fix the brand new economical inefficiencies of the law and the liquidity needs of the markets participants.

⁷² Cf. for instance art.57 MIFID II establishing the EEOTC, which illustrates well this « *same foot* » policy.

Appendix

Key differences

Key differences between trading venues

	Regulated Market	MTF	OTF
Financial instruments	Equity and non-equity	Equity and non-equity	Non-equity only
Execution of transactions	Non-discretionary	Non-discretionary	Discretionary
Proprietary capital	Prohibited	Prohibited	Prohibited, with exceptions
Matched principal trading	Prohibited	Prohibited	Permitted in some cases with client consent
Own account trading	Prohibited	Prohibited	Permitted with respect to illiquid sovereign debt instruments

Source EY

Average size per trade

Figure 1: Average size per trade

