NYSE plans ‘dark orders’ for retail customers

By Telis Demos in New York

NYSE Euronext has launched a new programme in the US aimed at taking back market share from dark pools at the same time as challenging the Securities and Exchange Commission to revisit its rules.

The New York Stock Exchange has filed a request with the US regulator to offer so-called “dark orders” exclusively to retail customers. NYSE’s retail liquidity programme would allow brokers representing small-time investors to receive prices that were at least $0.002 better than the current market price.

The exchange would also create a class of traders who would pay a fee but also receive incentives for posting such orders only for retail customers, called Retail Liquidity Providers, or RLPs.

This structure, though not currently allowed under SEC rules for public exchanges, replicates what happens in so-called “dark pools”, where prices are not displayed and owners of the pools are allowed to discriminate for or against certain types of orders.

“It remains to be seen if the SEC will approve this,” said Joe Mecane, chief administrative officer for US markets. “But it helps to move the market structure conversation forward and helps to also further level the playing field between different types of venues.”

Banks such as Citigroup have developed venues that prioritise retail orders, while Credit Suisse has a venue that excludes high-frequency traders. Dark pools have in recent years been stealing market share from exchanges, with about 30 per cent of all US stock trades now taking place outside of exchanges such as the NYSE and Nasdaq.

“It’s a big deal that a major exchange is trying to offer an alternative to the off-exchange payment for order flow market,” said Justin Schack, analyst at Rosenblatt Securities.
While exchanges are allowed to use dark or “hidden” orders, they cannot offer them only to certain customers. Collectively, dark pools traded about 11.3 per cent of US equity volumes in August, according to Rosenblatt Securities, while exchanges’ dark orders were 3.9 per cent of US flows.

A large portion off-exchange trades, are said to have come from retail trading. Rosenblatt estimates that about 10 to 15 per cent of all trading is retail flow internalised by wholesale market makers, a group that includes Knight Capital, Citadel, UBS and Citigroup.

Retail flow is prised because most trades by small investors are made with long-term price shifts in mind, while many professional traders – including high-frequency groups – profit from price moves on scales as short as a millisecond.

The NYSE will designate “retail member organisations” when member brokers attest that their orders came from retail or from another non-member handling retail trades, according to NYSE’s filing.

Bringing back more retail flow would also enable NYSE to capture more high-frequency trading, said Mr Mecane. “I think it will get some traction and it will fit well into the ecosystem. It won’t move massive flow but we’ll become a part of the fabric,” he said. “We want to aggregate as diverse a pool as possible.”

The SEC will likely take a close look at the proposal. The agency has been debating whether or not dark pools and sub-penny price increments are good for markets and liquidity, a process it began in 2009.

The regulator has also raised the possibility of a rule that would require greater price improvements to discourage off-exchange trading but other issues, such as the “flash crash” and the Dodd-Frank reforms, have taken up the bulk of the agency’s resources.

Some high-frequency market makers may oppose the proposal. While sub-penny price trade executions are allowed under current rules, no trader can submit quotes at sub-penny increments.

“Market-makers are trying to attract order flow by being fast and having the best price. They would have to compete with the NYSE’s price,” said Bernard Donefer, professor at Baruch College.