

Summary of Inquire Europe research proposal

NASDAQ-OMX's Switch to and from Post Trade Anonymity: What do we learn about Winners, Losers, and the Overall Impact?

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Anonymous trading is the norm in today's equity markets in that no information about counter parties in a trade is publicly revealed. Over a number of years numerous exchanges have become more anonymous as they have become fully electronic and the common wisdom is that anonymity and efficiency go hand in hand. Yet, in other ways the debate about what information should be available publicly is not settled yet as trading on dark pools or through algorithms become more important. As the excerpt below illustrates, one exchange operator, Nasdaq OMX, is still on the fence in that its Nordic stock markets is moving towards that goal but is not there yet:

“On June 2nd 2008, NASDAQ OMX Nordic *introduced post trade anonymity* on the Helsinki market and on the five most traded shares in Stockholm. *That decision was based on member consultation* conducted at the end of 2007 and in early 2008. Following further consultation in February and March 2009, NASDAQ OMX has decided to remove the anonymity for the five shares on the Stockholm market, and change to have post trade anonymity for only the five largest shares listed in Helsinki.”

In addition the rules concerning trade anonymity on the Copenhagen exchange remained unchanged. All three markets are part of the Nasdaq OMX Nordic Market Segment and operate essentially the same trading platform in all three markets.

The implementation of post trade anonymity on the Nordic markets of Nasdaq OMX (Sweden, Finland, and Denmark) in June 2008 was unique in that it was designed as a quasi natural experiment. The “treatment” group included all stock trading on the Finnish market, the five most active stocks on the Swedish market, and none of the listings on the Danish market. The market structure is exactly the same since all three markets have the same operator, NASDAQ OMX. Exchange memberships vary across markets but there are several that are members of all three. Finally, due to cross-listings there are some stocks that trade across two markets; most often it is Finland and Sweden or Sweden and Denmark. To summarize, the nature of the implementation comes close to the experimental ideal.

We expect to document how the trading and order placement behavior differs across the anonymous and transparent regimes. This difference can be broken down across types of exchange members where perhaps the most important distinction in this case is between domestic (internal) and foreign (external) members. This is also what makes our proposed study a “quasi” rather than a “pure” experiment. The extent to which anonymity was introduced was inversely related to the influence of domestic exchange members. We hope to collect data on the pre implementation membership vote.

Some key aspects of the data that are worth emphasizing are: (i) trade counterparties information became public after 18.00 in the anonymous regime, (ii) we observe the counterparties of trades in our data that we have secured from Nasdaq-OMX. In addition, a code that assigns each trade counterparties to four categories including algorithmic or program is observed. Finally, we have not yet collected the data for a second event that reversed part of the first one's changes. This happened less than a year later and underscores how divided the membership was about post trade anonymity.

Institutional investors and portfolio managers worry that in a transparent regime their large trades signal their trading intentions before their orders are completed resulting in higher trading costs. Conversely, in smaller stocks some institutional investors and portfolio managers argue that this risk and cost is dominated by a search costs that is higher with anonymous trading. We expect to shed some more light on how transactions costs and time to completion for larger trades depend on the rules regarding anonymity across stocks and member profiles.

It is often argued that with the rise of sophisticated trading algorithms the anonymity is more important because of the computers greater processing power and speed. In a transparent market trade counterparty information may quickly be picked up by an algorithm, spitting out a series of orders in response to the information that was released. It is, of course, challenging to show that some order would not have been submitted had the market been anonymous. But this event and the detail of the dataset make it possible for us to comment on how different types of trading, e.g., algorithmic, program, or broker assisted, trading responded for similar types of stock around the change.