‘Dark Pools’ Draw More Trading Amid Low Volatility

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The calm markets of recent months have meant more trades are getting done in the dark.

Dark pools—private trading platforms, typically geared toward big investors—have enjoyed growing market share this year. The share of U.S. stock trades executed on dark pools and other off-exchange trading venues rose to 38.6% in April, the highest level in more than a year, according to research firm Tabb Group, and up from 34.7% in December.

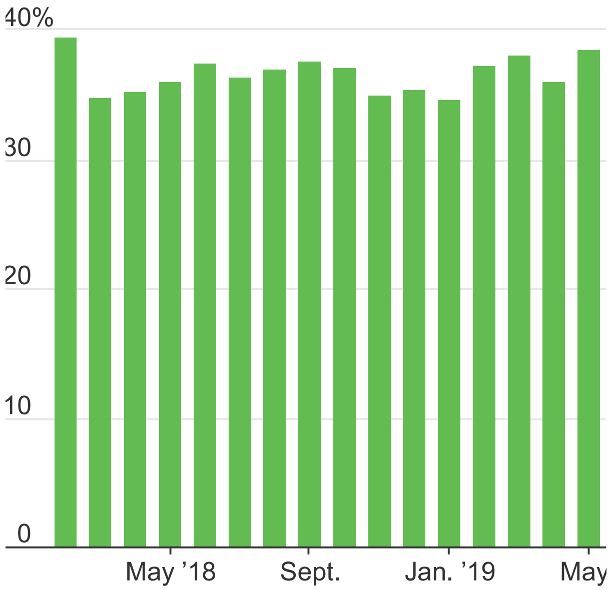
When markets are volatile, traders flock to stock exchanges, where orders to buy or sell are publicly displayed. They are in a greater hurry to buy or sell shares before prices move in an unwanted direction. Broadcasting orders to everyone else in the marketplace helps draw interest, helping to ensure that trades get done quickly.

Dark Days

More trading takes place in dark pools when markets are less volatile. In April, the share o
off-exchange trading in U.S. stocks hit its highest level in more than a year.

Percentage of all U.S. stock trades executed outside of exchanges

Source: Tabb Group



But some investors, especially hedge funds or other big players looking to amass or dump large quantities of shares, don’t want to tip off the broader marketplace about their intentions, for fear that it will result in them getting a worse price.

Such players may seek to execute their trades on dark pools. These trading platforms—which are formally called automated trading systems—keep orders hidden. There are more than 30 dark pools for stocks trading, with the largest run by banks such as UBS Group AG, Credit Suisse Group AG and JPMorgan Chase & Co.

“If markets are calmer, traders can take more time searching in the dark” for buyers or sellers, said Bryan Harkins, executive vice president at exchange operator Cboe Global Markets Inc. “There’s less urgency to get the trade done.”

Dark pools have periodically stirred controversy. Since 2011, the Securities and Exchange Commission and New York Attorney General have collected more than $340 million from dark pool operators to settle various allegations, including false marketing and exploiting confidential customer data for their own trading purposes.

Last year, the SEC approved new rules forcing dark pools to be more transparent about how they operate. But they are still subject to looser regulation than stock exchanges.

Exchanges often gripe that the rules put them at a disadvantage. The New York Stock Exchange, Nasdaq Inc. and Cboe sued the SEC in February to block a pilot program that would limit the fees exchanges collect for trades as well as the rebates they pay to encourage trading activity. One of their main complaints: The pilot only covers exchanges, not dark pools.

“The program unfairly penalizes lit exchanges compared with their competitors, the dark pools,” NYSE President Stacey Cunningham wrote in a February opinion piece in The Wall Street Journal. By targeting exchanges, the pilot will hurt the transparency of public markets, she argued.

An SEC spokesman declined to comment. The bulk of the SEC’s pilot program is now on hold as both sides await a decision from the U.S. Court of Appeals for the District of Columbia Circuit.

Operators of dark pools say they fulfill an important need in the marketplace. Exchanges will often attack dark pools when their businesses come under threat, said Adam Sussman, head of market structure at Liquidnet, a New York-based firm that runs two dark pools for U.S. stocks.

“Nothing has changed dramatically in the relationship between how people trade on and off exchange,” Mr. Sussman said. “An increase in rhetoric around ATS trading is going to be influenced by the pressure exchanges are feeling in their own business.”

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