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NYSE Readies Its Block Initiative

The New York Stock Exchange aims to attract blocks and further differentiate itself from its chief rival Nasdaq when it launches New York Block Exchange later this month. The Big Board expects the Securities and Exchange Commission to green-light the NYBX initiative next week.

"NYBX will help us bring blocks back," said Joe Mecane, executive vice president for U.S. markets at NYSE Euronext. "It's part of our block trading strategy, which is an important part of the [NYSE] strategy. Issuers value the fact that we try to foster relative transparency and lower market-impact costs by having a block strategy."

NYBX could halt the NYSE's declining average execution size and cause it to edge back up a bit, according to Mecane. "One of the biggest complaints in the industry and from the buy-side is not being able to get size done," he said. "If you create a venue with success in printing larger-size transactions, you get a good feedback loop." However, he acknowledged, it takes a lot of big orders "to move the needle."

Last month, 23 percent of NYSE's volume was executed via blocks of over 10,000 shares. Fifteen to 20 years ago, about half of New York's volume was blocks. The exchange's market share in its own listed names was around 27 percent last month. Several years ago, before Regulation NMS went into effect, it was about 80 percent.

Joe Ricciardi, managing director at Knight Equity Markets, notes that NYBX is on his firm's radar, even as it joins other

block crossing venues in a "pretty competitive space." He added: "If the NYSE has a superior product, it'll get traction and we'll use it."

NYBX is essentially a dark pool at the heart of the NYSE. But unlike crossing systems and broker-sponsored dark pools, this venture brings together dark liquidity and the NYSE's deep order book of displayed and reserve, or non-displayed, orders.

Jamie Selway, managing director at broker White Cap Trading, notes that NYBX is different from other block initiatives. "Tapping into the reserve books of exchanges is the Holy Grail of dark pools" because of the latent liquidity they represent, he said. "The NYSE has talked about re-aggregating trades into blocks for years, but this represents a real effort to do so electronically."

NYBX, an electronic facility of NYSE, is a 50-50 joint venture between NYSE and BIDS Holdings, the parent of the BIDS Trading dark pool. (The latter, which is also geared to blocks, is a separate dark pool that currently connects about 40 sell-side and 35 buy-side firms.) As part of the joint venture, BIDS became a NYSE member and NYSE took an equity stake in BIDS.

NYBX will continuously match and execute orders sent into its facility. Non-displayed orders can be sent into the facility in one of two ways. NYSE member firms and their customers can submit orders to NYBX, and BIDS users can opt to send orders to NYBX in addition to the BIDS dark pool. NYBX orders can include a

"minimum triggering volume" to avoid the problem of not getting enough of an order executed. NYBX accepts limit orders and pegging orders, but not market orders.

In seeking contra-side liquidity, the NYBX facility will aggregate displayed liquidity and hidden reserve orders in the New York's display book as well as dark orders from BIDS that have elected to sit in NYBX. NYBX allows executions outside the national best bid or offer, and routes out orders, as necessary, to execute against protected quotes if an NYBX execution would otherwise trade through those quotes.

Tim Mahoney, CEO of BIDS, notes that NYBX offers more flexibility than existing dark pools. NYBX can be used by both buy-side and sell-side traders, he said, and NYBX orders can interact with the public displayed market and dark liquidity. "In some block pools, traders are constrained right now," he said. "They can trade only with institutions and [typically] at the midpoint. There's more opportunity if they can trade at a premium or discount to the last sale and can trade with the public marketplace as well."

Another benefit is the NYSE's reach. "NYBX is a utility," Mahoney said. "It's open to any member of the NYSE, and the NYSE has a big footprint." He added that BIDS comes into the facility just like any other member accessing NYBX.

White Cap's Selway agrees. "Why is this more interesting than the Son of Pipeline launching?" he said. "More peo-

ple can get to it and [the facility's] information about the NYSE's book is unparalleled. NYBX knows for certain what's in the display book." He adds that the NYSE's "liquidity and distributional footprint" effectively means that the "NYSE won't have to sell the product."

In Mahoney's view, NYBX also helps traders by enabling them to execute outside the NBBO. "If I'm buying 50,000 shares and I'm willing to pay 3 cents over the offer, I'm not worried about paying a premium," Mahoney explained. "I'm worried about trading just 10,000 shares and the market impact that could result." He added that executing away from the inside market improves the trader's chance of getting a block executed, and that using a minimum size will "protect their information by avoiding the problem of not getting enough done or getting a lot of small executions, which results in information leakage."

An NYBX user can specify, for instance, that he wants to trade a minimum of 50,000 shares. In that case, NYBX will execute the order only if the requisite number of shares is available in aggregate at the user's limit price or better in the display book and NYBX. Orders in NYBX execute against

New York's display book first, before checking NYBX for liquidity, unless NYBX has a better-priced contra-side order.

Selway thinks the minimum size is critical for blocks but isn't sure institutional traders will seek executions outside the NBBO in the current volatile market environment. "It's tricky to execute outside the NBBO, especially when you're dealing with institutions that want certainty," he said. "There's now a fascination with the midpoint, mainly because crossing systems use midpoint pricing."

Mecane said he expects the rollout of NYBX to encourage traders to layer the NYSE book with hidden orders in the hope of getting executed if a large order comes into the facility. The NYSE launched reserve (dark) orders for all NYSE members in November. Previously, only floor brokers could place dark orders in the New York's book. "Traders putting in larger orders at various price points and algorithmic firms that utilize those dark order types will see better fill rates once NYBX goes live," Mecane predicted.

The New York will charge NYBX users a fixed rate that is higher than the fee for taking liquidity from the NYSE but in

the ballpark of what other market centers charge liquidity takers. The fee schedule for orders in the display book that receive executions against NYBX orders is not affected by the pricing for orders sent into NYBX.

NYSE's designated market makers and supplemental liquidity providers will not initially be able to send orders into NYBX. Their quotes in the NYSE book, however, could provide the contra side to NYBX orders. The New York may allow DMMs and SLPs to participate in NYBX's "phase two," Mecane said. That change would require regulatory approval.

Additional potential plans for NYSE's new block facility include allowing other liquidity pools such as NYSE Arca and NYSE Alternext (formerly the American Stock Exchange) to participate in NYBX. Arca, for instance, could augment the Big Board's pool of liquidity. NYBX could also be expanded beyond NYSE names. "We are starting with Tape A," Mecane said. "Whether we do Tape B or C next, or both, hasn't been finalized." Eventually, the exchange may look for ways to integrate its MatchPoint trading facility with NYBX, he added.