IOSCO: Principles on dark liquidity. July 2011.

The Technical Committee of IOSCO has published on may a final report that contains principles to assist securities market authorities, markets themselves and participants in dealing with issues concerning dark liquidity, that includes dark pools (non pre transparency markets) and dark orders (non pre transparency orders in transparent markets).
Dark pools regulation varies both across and within the different jurisdictions and can be differentiated based upon a number of characteristics: right to access to dark pools (depending on the operator and structure of the dark pool), permitted order types and order submission, the price determination process and the order execution pattern. Dark orders are typically subject to the same regulations as displayed orders, with the major exception being that they are not subject to pre-trade transparency requirements.

The principles establish that pre- and post-trade transparency are central to minimise the adverse impact of the increased use of dark pools and dark orders on the price discovery process and to mitigate the effect of any potential fragmentation of information in the market. IOSCO´s Technical Committee recommends that regulators consider the structure of their respective markets as a whole to determine how best to implement these principles in such a way as to maintain the efficiency of the market and the integrity of the price formation process.

The six principles are focused on the following areas of regulatory concern:

Transparency to market participants and issuers.

Principle 1: Pre-transparency. The price and volume of firm orders should generally be transparent to the public. However, regulators may choose not to require pre-trade transparency for certain types of market structures and orders. In these circumstances, they should consider the impact of doing so on price discovery, fragmentation, fairness and overall market quality.

Principle 2: Post-transparency. Information regarding trades, including those executed in dark pools or as a result of dark orders entered in transparent markets, should be transparent to the public. With respect to the specific information that should be made transparent, regulators should consider both the positive and negative impact of identifying a dark venue and/or the fact that the trade resulted from a dark order.

Priority of transparent orders.

Principle 3: In those jurisdictions where dark trading is generally permitted, regulators should take steps to support the use of transparent orders rather than dark orders executed on transparent markets or orders submitted into dark pools. Transparent orders should have priority over dark orders at the same price within a trading venue.

Reporting to regulators.

Principle 4: Regulators should have a reporting regime and/or means of accessing information regarding orders and trade information in venues that offer trading in dark pools or dark orders; information must be accurate so that regulators get to know the volume of trading that occurs in dark pools or as a result of dark orders.

Information available to market participants about dark pools and dark orders.

Principle 5: Dark pools and transparent markets that offer dark orders should provide market participants with sufficient information so that they are able to understand the manner in which their orders are handled and executed and the risk of trading in that market.

Regulation of the development of dark pools and dark orders.

Principle 6: Regulators should periodically monitor the development of dark pools and dark orders in their jurisdictions to seek to ensure that such developments do not adversely affect the efficiency of the price formation process, and take appropriate action as needed.

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