

Shedding light on dark markets

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The findings challenge the belief that private exchanges can lead to a lack of transparency in markets. Credit: University of Melbourne

Trading of shares and other financial instruments on decentralised or "dark" markets has no effect on the transparency of price information or the way in which those prices are determined, according to new research by the University of Melbourne.

These findings by Professor Peter Bossaerts from the University's Faculty of Business and Economics and Professor Elena Asparouhova from the University of Utah have been published in this month's issue of the *Economic Journal*.

Professor Bossaerts said the findings challenge the belief that private exchanges can lead to a lack of transparency in markets.

"Dark markers have become part of the landscape of advanced financial markets around the world, including in Australia, and regulators have been struggling with how to regulate them in an informed way," he said.

Professors Bossaerts and Asparouhova conducted groundbreaking controlled experiments to test whether trading in dark markets - which have come under intense scrutiny since the Global Financial Crisis - obscured public [market prices](#).

This involved using the "Flex-E-Markets" online trading platform, which the researchers developed. Participants or "investors" in the experiment were given securities to trade in both private and public markets. Each was given a private signal - an informed guess that they alone could see - of the final values of the securities.

"We found that the average transaction price in both types of markets, centralised and decentralised, correctly aggregated the private signals," Professor Bossaerts said.

"Transactions did not necessarily take place at the correct price, but stayed within narrow bounds of the correct price, implying that everyone was trading fairly."

The research is timely as it comes ahead of European reforms to be introduced in January that are designed to significantly restrict [trading](#) in dark markets, reforms drafted because the Europeans believe such markets cannot generate fair pricing.

"This is relevant for Australia as well, not only because Australian financial services companies participate in financial markets in the EU, but also because EU (and US) regulations are often a benchmark for new rules here," Professor Bossaerts said.

"Without controlled experimentation, the conclusions of financial regulators like the European Securities and Markets Authority are mere conjecture."

Provided by University of Melbourne

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