

# Building Blocks

## JSE Answers Call for Large Trade Anonymity

*Leanne Parsons, Head of Equities Trading at the JSE speaks about BlockX and how it marries the efficiencies of a transparent market with the need for more anonymity for larger trades.*

In an era in which the average transaction size is declining world-wide, the Johannesburg Stock Exchange (JSE) is set to introduce on-exchange anonymous trading functionality to limit the market impact costs related to large transactions. Dubbed BlockX, it will allow for complete anonymity in the execution of large trades through hidden order functionality in the JSE's existing central order book.

Launched in June 2010, BlockX is aimed at institutional investors looking to acquire or sell large tranches of shares. International regulatory concerns have been taken into consideration in the development of the new functionality. "The global proliferation of dark pools in response to Reg NMS and MiFID has not escaped the South African environment," comments Parsons. "Our large traders have made it clear to us that while a transparent central order book has numerous advantages, this transparency sometimes has its costs," she adds.

Like many other leading exchanges, entering the fray is a way for the JSE to retain trading which may otherwise migrate to new venues that provide dark pools. The concept, which took 18 months from conceptualisation to launch, marries the benefits of a dark pool with those of the central order book. "Although



*Leanne Parsons, Head of Equities Trading, Johannesburg Stock Exchange*

we are considered a highly innovative exchange, we tend to take a cautious approach when developing a new business case. On this occasion, many months were spent on researching dark pools internationally and cherry-picking elements to create this hybrid," adds Parsons. As yet, the pricing model hasn't been finalised.

One clear advantage of the BlockX model lies with its interaction with the lit market. As the facility will not be a separate dark pool, it will not fragment liquidity. Much of the controversy surrounding dark pools has centred on the fact that they draw liquidity away from the public markets and a two-tier

market is created; one for larger players and one for smaller players. On the contrary, Parsons believes that it will encourage greater liquidity. "The JSE is hopeful that Block X will prompt increased trading in the local market by bringing the latent liquidity of large orders on dealers' desks

**"Block X will prompt increased trading in the local market by bringing the latent liquidity of large orders on dealers' desks into the market more quickly."**

into the market more quickly." Minimum order sizes (MOS) and minimum execution sizes (MES) prevent gaming of orders. The JSE has specified additional requirements of what can be built into the software that interacts with the bourse's equities trading platform. The exchange also has the authority to disconnect users that operate electronic trading programs that behave against its regulations. Trades resulting from hidden orders will be immediately published to the market once successfully matched. "We haven't put aside the ideals of price discovery and transparency that the central order book offers," says Parsons.

Parsons anticipates a wave of regulatory pressure internationally to change how dark pool activity

is managed and reported on. In South Africa, the changes to the JSE rules are waiting for final regulatory approval from the JSE regulator, the Financial Services Board (FSB). The FSB has been consulted throughout the development process and has approved the concept in principle. The JSE's regulation is recognised as world class. The World Economic Forum Global Competitiveness Report for 2009-2010 ranks South Africa second out of 133 countries for Regulation of Securities Exchanges.

Increased trade due to the introduction of BlockX should build on recent trade growth which may have been buoyed by a revised equities billing model. The billing system, implemented to recognise both low value and high volume traders, has been effective since 1 March 2010. Trading statistics for March and April have shown increases, with latest statistics showing that cash equity transactions for the four months to end April 2010 are up 18.17% on the same period in 2009 (2010: 7,625,903; 2009: 6,453,175)

*Source: JSE Market Profile- April 2010*

Developing an anonymous block trading facility is only one of the JSE's initiatives to attract trade and increase liquidity. The JSE, which will also be FIX enabled by Q3 2010, has a track record of innovation with the exchange being one of the first to allow Direct Market Access (DMA) for investors. "As competitive pressure in the global exchange environment builds, innovation becomes increasingly important. We are certainly not taking our foot off the pedal in this respect," concludes Parsons.

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