It's 1966 all over again and see-through is back in fashion. In the financial world, 'transparency' has become the new fashion statement. For example, to quote one 'entrepreneur', Brian Forde, in Sydney last week

We say sunlight in government is the best disinfectant, and Blockchain makes things more open and transparent

Yes, Blockchain is the new black or should that be new transparent?

But, of course, transparency is matter of which side of the two-way mirror that one is on and the financial industry is particularly adept at having a peek at places it is really not supposed to.

In a recent speech the head of the ASX, Elmer Funke Kupper, extolled the virtues of the new black, even pitching in a few millions dollars of shareholders' funds

Every now and then, something comes along that might just change everything. And this is one of those moments

As an example of how Blockchain might help, Mr Kupper gave the example of the failed stockbroker BBY arguing that it would "speed up the resolution of major disruptions". But Mr Kupper was less than transparent in not stating that the BBY administrators (KPMG) reported that the ASX was aware of compliance problems at BBY for over a year before the company went into administration (in fact aiding BBY by delaying margin calls). The problem with BBY was not technology, as the ASX had all the information they needed for months, but was a failure of the ASX to properly regulate one of its brokers.

Another example of motes not being removed from eyes is that of the Commonwealth Bank of Australia, where the Chief Information Officer, David Whiteing, enthused that Blockchain "is clearly, in very clear terms, faster, cheaper and more transparent than some of the existing practices we have today". Couldn't be any clearer?

Maybe in the light of the failure of the CBA to report internal fraud to the police for over four years, a little introspection on the benefits of transparency might be in order in Martin Place. Technician heal thyself.

There are so many cases of financial institutions saying one thing and doing completely the opposite, one could fill a dozen Blockchains but a recent example of lack of transparency illustrates the Janus-like behaviour of our financial institutions and regulators.

If the ASX management were serious about transparency there is an easy solution at hand – close down Centre Point. No, not the ugly building in central Sydney - but ASX's very own 'dark pool'. According to the ASX 2015 Annual Report, Centre Point accounted for some 18.1% of ASX's trading revenue. Lack of transparency can be very profitable.

What is a dark pool? As the name suggests it is about reducing transparency and promoting obscurity. According to ASIC, a dark pool or dark liquidity "refers to orders that are not known to the rest of the market before they are matched as executed trades". In other words, there is no transparency as to the size of orders being traded nor who is trading at what price until *after* the trade is agreed.

Just last October, ASIC published an excellent report entitled a "Review of high-frequency trading and dark liquidity". At the time, much of the discussion around the report was about the HFT (High Frequency Trading) part of the report, but the research on so-called 'dark liquidity' was equally enlightening.

Why would anyone want to trade in a dark pool?

The traditional reason for trading within a dark pool is not to alert the rest of the market of one's intentions to buy or sell a large amount of securities. If others in the market find out that someone is desperate to buy or sell a large amount of something then they are (naturally) going to push the price up or down against the trader.

No doubt the poor shareholders of NAB wish that they had been able to sell their Clydesdale shares in a dark pool, given the losses that occurred when the market knew there was going to be a fire-sale for that particular white elephant.

The traditional intention of a dark pool is to allow someone to trade in large block sizes. But according to ASIC, it hasn't quite worked out like that.

ASIC reported that, in 2015, the median size of a trade on Centre Point, which accounts for some 20.9% of total dark volume, was some $976, or about 13 shares of CBA. The average size was somewhat bigger at about 60 CBA shares, but still hardly market-moving numbers. The smaller Chi-X exchange had a slightly higher median size but much smaller average size of trade. Together these two exchanges handle just under 100,000 dark trades on an average day. In addition a number of so-called 'crossing networks', or private dark pools, are operated by large banks such as Credit Suisse, JPMorgan and Merrill Lynch and account for some 9% of total dark trading.

But why such small trades, when the purpose is to trade in large market-moving lots?

High Frequency, ie automated, traders appear to be the villains of the piece, as they to tend to make lots of small trades, making cents off each trade but lots of money overall due to the sheer volume that they generate. In itself that is pretty much what HFT traders do, but ASIC found that in exchange dark pools, such as Centre Point, HFT traders have a decided advantage in that they appear to be "on the winning side" of trades some 85% of the time while ordinary "agency" clients appear to be on the "losing side" some 68% of the time.

In other words, the exchange dark pools appear to be stacked against ordinary punters.

But that should come as no surprise. Just this month, Credit Suisse and Barclays were fined over US $150 million by the US Securities and Exchange Commission (SEC) for misleading investors and violating securities law in the way they operated their private dark pools. Basically, the banks fibbed about how their dark pools actually worked - there was a lack of transparency, about the lack of transparency.

While the ASIC report unfortunately did not make any specific recommendations on the operations of dark markets in Australia, it did provide a long list of expectations for compliance and supervision arrangements for operators of dark pools, in particular internal policies for managing conflicts of interest. If the ASX is so hot on transparency maybe they could let the markets know just how Centre Point and other ASX participants are meeting ASIC's expectations, particularly around HFT.

But transparency is not the real issue, of course.

Last August, ASIC celebrated five years as market supervisor (time flies) and was especially proud of its Markets Analysis and Intelligence (MAI) surveillance system, which replaced the SMARTS surveillance system that ASIC inherited from the ASX when it became the market regulator

In addition to its real-time surveillance capabilities, MAI also enables ASIC to interrogate very large data sets and as analyse granular information on the behaviour of traders

If transparency really was the goal, then ASIC could quite easily put all of the information that it collects in MAI (many times that possible using Blockchain) onto the Cloud for free so that everyone could see and analyse trading activity for themselves. But that is unlikely to happen, as few professional traders would welcome public access to "granular information on their behaviour".

Nor do the big market participants want universal sunlight. Having quickly come to the conclusion that the 1980's era technology behind the Blockchain would not work for tens of thousands of traders and millions of transactions per day, they have come up with the concept of the 'permissioned Blockchain'. Note, 'permissioned' here actually means private and closed.

It is reported that CBA has joined just such a “consortium of global banks that have already tested a Blockchain to transfer value between each other”. It is highly unlikely that such a consortium (of the ‘same suspects’) will forgo their insider information advantage for the transparency that they so loudly espouse in public.

The great moral philosopher and part-time economist, Adam Smith, saw through such activities pretty well

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices

Maybe some transparency on the motives behind ‘permissioned’ Blockchains might be in order?

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