DESIGNING ORDER-BOOK TRANSPARENCY IN ELECTRONIC COMMUNICATION NETWORKS

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Abstract
A significant fraction of trade in stock exchanges (e.g., Euronext and NASDAQ) involves “iceberg orders,” which are orders to sell or buy a certain number of shares with the caveat that only a part of that number be made public. This paper provides a normative justification for the lack of transparency in this kind of orders: imperfect disclosure is shown to be a necessary feature of any optimal mechanism when the asset’s potential buyers must incur a cost in order to become active and learn their valuations for the asset. This finding raises a caveat for regulation that seeks to mandate the open order-book or otherwise increase the pre-trade transparency of stock exchanges. (JEL: D02, D47, G01)

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