Limit Orders and Volatility in a Hybrid Market: The Island Ecn

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Abstract

This paper is an empirical analysis of trading activity on the Island ECN, an electronic communications network for US equities, which is organized as an electronic limit order book. The approach is cross-sectional across firms. The goal is to characterize the firm-specific determinants of Island activity, with particular emphasis on the volatility of the firmâ¬"s stock. We find that Islandâ¬"s market share for a given firm is positively related to the overall level of Nasdaq trading in the firm. Across a number of volatility proxies, we find that higher volatility is associated withâ¬¢ a lower proportion of limit orders in the incoming order flowâ¬¢ a higher probability of limit order executionâ¬¢ shorter expected time to executionâ¬¢ lower depth in the book.In addition, we find substantial use of hidden limit orders (for which the submitter has opted to forgo display of the order). Finally, over one quarter of the limit orders submitted to Island are canceled (unexecuted) within two seconds or less. The extensive use of these â¬Sfleetingâ¬? orders is at odds with the view that limit order traders (like dealers) are patient providers of liquidity.

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