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Next steps in bond trading: All-to-all matching catching on?

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Corporate bond trading platforms are in the news again.

Platforms that have launched innovative all-to-all trading protocols are attracting buy-side firms to their venues. Despite skepticism a few years ago that all-to-all platforms wouldn't attract liquidity, platforms like MarketAxess with Open Trading and Liquidnet's have gained traction on the buy side and increased their volumes over the past year.

"I'd say that all-to-all trading has really been a big driver of 2016. I think when we look at our volumes, you'd see that all-to-all trading has had a big impact on us," said Amy Koch Flynn, global head of fixed income trading at Standish on a TABB Forum video, "The Limits of Electronic Trading in Fixed Income."

As a result of regulations that caused the dealers to reduce their balance sheets and retreat from market making, MarketAxess developed Open Trading to allow buy-side firms to trade with one another or with the sell side.

"Open Trading is a term describing the ability of clients to tap into the broader MarketAxess liquidity network, which could be other buy-side clients or dealers they don't have as direct counterparties," said Gareth Coltman, head of European product management at MarketAxess. Under the EU's MiFID II reform going into effect on Jan. 3, 2018, asset managers will need to demonstrate best execution to their clients and collect all the necessary data points.

In the second half of 2016, MarketAxess reported that over 270 asset managers and 40 banks were using Open Trading in Europe. Asset managers provided half the liquidity on Open Trading during the second half of 2016. Among the new protocols launched in June of 2016 was Private Axes to let the buy and sell side anonymously advertise their interest and negotiate block trades without market impact.

Liquidnet's blotter sweeping technology and centralized network of natural liquidity has caused institutions to prioritize connectivity to its income trading platform.

Since launching in September of 2015, Liquidnet's all-to-all fixed-income platform has increased to $7 billion of order flow per day. In January of this year, it had more than 230 different institutional firms and over 165 users.

However, it's not time to celebrate yet.

While the corporate bond market has been expanding over the past eight years to more than $8.5 trillion in notional value, most of these bonds do not trade very much. Insurance companies, pension funds and mutual funds hold these bonds but can have a herd mentality. "If there's a declining credit, or volatility, these markets on electronic platforms are not there for you. So, I think that that's a misnomer that people don't truly understand," said Koch Flynn.

Most of the lack of liquidity is outside of the top 1,000 bonds and in the other 14,000 bonds, he said. "That's where the liquidity problem is," said Constantinos Antoniades, head of fixed income at Liquidnet. According to Antoniades, the top 750-1,000 corporate bonds account for 45% of US corporate bond volume, while the other 14,000 bonds account for about 55% of the market's volume.

But, the lion's share of electronic bond trading is still taking place via request-for- quote (RFQ) methods, which relies on the dealers for supplying pricing and liquidity. "There is a lot of behavioral inertia behind RFQ. What we've done is blend together RFQ with these more progressive ways of trading, such as all-to-all. That has made it easier for clients," said Coltman. Within the RFQ protocol, MarketAxess offers Market Lists to enable the buy side to send queries anonymously to the dealers.

While electronic RFQ systems are good for trades $1 million and under, many of the all-to-all platforms are focusing on larger size trades, $2 million and up. RFQ has made "dealer-to-client interaction more efficient but it still has not solved the real problem of the large institutional trades which can be solved with a natural opposite," said Antoniades.

But Antoniades points out that buy siders are taking more control.

In the summer of 2015, Liquidnet launched Targeted Invitations in the US and Europe, a trading protocol that notifies the buy side when an institutional buyer or seller has posted liquidity across its network. “This helps bridge the time gap,” said Antoniades. For example, the same person might have been a seller of a particular bond yesterday, but returns to the pool as a buyer today. Secondly, it allows someone to seek liquidity in multiple bonds of the same issuer or the same bond. “A lot of times a trader is happy to buy a bond that matures two years earlier or two years later,” he noted. Another feature revolves around substitute bonds, not the same issue, but perhaps finding liquidity in another issue.

Buy-side firms are acknowledging the progress of all-to-all bond trading platforms, but at the same time, they have a hard time integrating disparate systems that cater to specific asset classes within fixed income.

“While all-to-all systems are helpful with odd lots, what we see is a lot of niche players who are solving for one aspect within a certain asset class,” said Koch Flynn. “While that is great to see, I wish we could see more innovation by the big guys who are already connected, who have the STP and have FIX,” said Koch.

With 30-to-40 electronic trading platforms entering the fixed-income market, this can lead to fragmented liquidity across the various venues.

Last week, credit trading platform Trumid’s acquisition of Electronifie suggested that consolidation among the platforms is one way to solve the proliferation of dark pools that has led to fragmentation across the liquidity pools.

The deal is significant because it will allow TruMid to create a single all-to-all platform with over 350 institutions on TruMid Market Center, the company’s all-to-all trading network for corporate bonds. This includes 60 broker dealers and 20 of the top 25 asset managers, according to the firm’s statement.

Clearly, all-to-all platforms are still in their infancy. They are bringing more data analysis to the table. Many are working on integrations with third party systems like buy-side OMSs and execution management systems to aggregate liquidity across the credit markets. Fixed income asset managers like Standish are utilizing a variety of trading protocols ranging from RFQ to all-to-all, depending on the situation. Time will tell how they evolve, but buy-side participation in all-to-all trading platforms is growing against the naysayers.

Read more: https://www.finextra.com/blogposting/13934/next-steps-in-bond-trading-all-to-all-matching-catching-on