TECHNOLOGY FIRMS ARE LEADING THE WAY

# WHY TECHNOLOGY FIRMS ARE DRIVING ELECTRONIFICATION IN BOND MARKETS

For many years equities, FX and derivative trading desks have worked with smart trading tools that help develop new trading strategies, execute orders and perform post trade functions. In this article we look at four seismic shifts that are transforming the landscape of the bond market.

## 1 INCREASING ELECTRONIFICATION

Equity markets went electronic. Foreign exchange markets went electronic. For a number of years, it was also assumed that the bond markets would likewise march away from telephone or message based trading. The proportion of fixed income trades completed electronically has risen over the past decade, but not always at the rate predicted by pundits and analysts after the financial crisis. The shift to electronification is now gathering pace. Nearly a third of investment-grade corporate bonds were traded electronically at the end of 2019, a significant rise from 20 percent of trades two years earlier.

This shift has not, however, been evenly distributed across bond markets. Government bonds are the most liquid with around 64% of US Treasuries now trading electronically, and other G7 government markets such as Bunds not too dissimilar. While different forms of market structure were experimented with, the central limit order book (CLOB) has been a common place to trade these government bonds.

For credit, the proportion of electronic trading is accelerating as innovative technology and trader acceptance is leading to higher volumes on platforms, including larger and less frequently traded securities previously hampered by a lack of information. Both Marketaxess and Tradeweb, two of the largest electronic trading venues, saw a sharp increase in trading during the second and third quarter of 2020. The growth of volume that these venues, and other similar venues, have witnessed has been striking.

## 2 THE RISE OF ALL-TO-ALL TRADING

While traditionally corporate bonds have been traded through large sell-side dealers, regulation and cost-cutting around market-making has forced many banks to drastically pare back held inventory in the past decade. As a result all-to-all trading was developed; a new model was set up to fill the liquidity gap created by the sell-side. In all-to-all trade platforms, with protocols to protect information leakage, buy-side firms can directly trade with many bond investors and not just a handful of dealers. This has the potential to unlock inventory scattered in the holdings of thousands of pension, hedge and sovereign wealth funds around the globe. The all-to-all model has risen in popularity after a years-long industry-wide discussion about overall liquidity and inventory stemming from the liquidity crisis.

All-to-all trading allows for every party to participate equally and directly in the trading process. What's more, there are also substantial cost savings; MarketAxess, for example, estimated that clients saved $53.7 million during just one quarter by using its OpenTrading system. Other all-to-all bond platforms such as MTS BondPro and Trumid Market Center saw significant surges in volume during 2020.

In the US the SEC posted a white paper on the state of the market that the all-to-all trading platforms should be further developed. By allowing better communications directly between dealers and other asset managers they see "lower costs and additional sources of liquidity" while allowing buy-side firms to be 'price makers' in the market. While there has been some concern raised from traditional brokers, the overall market seems to be moving in the direction of embracing this model.

## 3 IMPROVED TECHNOLOGY FOR THE BOND TRADER

One shift in corporate bond trading from the buy side perspective has been the bifurcation of trades into low-touch liquid or small trades, and high-touch less liquid and block trades. AI and algos have also become a major feature of low-touch trading, freeing human resources for the high-touch, complex trades on the blotter. Every step-change on the technology side improves the efficiency and value of the traders focused on voice trades.

Standing in the way of greater efficiency and productivity in trading has been the dispersed nature of a bond trader's workflow. Taking a trade from investment research to execution required tracking and transferring information from multiple systems including, far too often,scribbles scattered in notebooks or Excel spreadsheets. This is where innovative firms like TORA fit in.

TORA's OEMS is a step-beyond many existing OMS systems used by participants in the bond market because it offers market-leading outward/market facing functionality designed for fast moving electronic trading on top of the classic internally-focused order management functions seen elsewhere. In a world where many market participants are already taking advantage of the changing bond market landscape, TORA clients are equipped with tools that are battle-tested in the electronic markets over the last fifteen years. The OEMS includes 'comparable bond' search tools, axe and inventory insights, historical analysis of trade execution quality, automated order routing based on bespoke rules, API trading and access to major platforms whether they use RFQ or all-to-all protocol.

Over many years TORA's solution has been designed to accommodate automated workflows and this comes into its own when applied to the bond markets. TORA's OEMS is also integrated seamlessly with other asset classes, improving efficiency and automation for the increasing numbers of asset managers who work in cross trading desks or multi-asset strategies. The OEMS provides asset managers with a single holistic view of all trading activities in any asset class.

## 4 THE COVID TEST – A PROVING GROUND

The durability and function of a particular market is frequently brought to light in times of crisis. The financial markets volatility brought out by the spread of the global coronavirus pandemic over the last 12 months is a good example of this.

The markets responded to the initial chaos with a sharp retrenchment. Bond trading platforms saw a sudden reduction in automated trading in the stressed markets. Humans stepped back in, but just for a moment. Electronic trading snapped back very quickly and immediately reached new levels of up-take in 2020. This test indicates the shift to electronification and automation in the bond markets is an accelerating path and traders should carefully consider industry partners, especially those in the technology sector, that can offer innovative solutions to help maintain, or even create, an edge.