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ICMA briefing note:

Electronic Trading Directory review & ETC member feedback, Q1 2022

Electronification within fixed-income trading continues to grow as a means of sourcing liquidity and providing connectivity. Since 2015, ICMA has maintained a database of solutions available for cash bond trading. Originally listing around 20 platforms, the Electronic Trading Directory (ETD) has evolved to now represent capabilities on over 50 trading venues, order and execution management systems (OMS/EMS), and bulletin boards.

Alongside the review of the ETD, ICMA gathered the views of members from the Electronic Trading Council (ETC) on the direction of travel with recent market developments and horizon scanning in electronic cash bond trading. The ETC comprises buy-side heads of trading desks, sell-side senior traders or heads of market structure and electronic trading and senior representatives from trading venues and technology providers, The market trends content is a consolidation of views shared through brief interviews and discussed within ICMA's November 2021 Secondary Markets Forum.

Key observations from the directory review

- The directory now includes 54 technology solutions, up from 49 in the December 2020 publication.
- The latest review brings an increased number of order and execution management systems (OMS/EMS), with 19 solutions listed to assist with the aggregation of market data, quotes, and trade orders.
- Several venues are no longer available for trading cash bonds and have been delisted.
- Additional information includes supported communication protocols & standards, delivery method (ie managed, licensed, hosted software) and market data services available.

Market trends: ETC member feedback

Common themes raised by ETC members included the ever-increasing importance of data, the efforts toward harmonisation of electronic communications standards, the use of various trading protocols and the evolution of portfolio trading.

Drivers and evolution of electronic trading

Pre- and post-trade processing efficiency gains continue to be the most important drivers of greater electronification and automation within bond markets. Automation is at the forefront of trading desks' minds – investing to be better, smarter, more automated. A reduction in the number of clicks required to execute a trade for example would be one outcome of greater efficiency. The trend towards electronification and automation, initially focused on sovereign bonds, seems to be naturally expanding to credit and further toward emerging and high yield markets.

Limitations on automation, however, still exist and the market turmoil during the height of the COVID pandemic brought with it a reminder of the role of traders. This is also evident from ICMA's

May 2020 report on the COVID-19 crisis on European investment grade corporate bond trading. Many algorithms ('algos') are still reliant on backwards-looking data and when market dynamics fall outside of their usual parameters human intervention is required beyond oversight and adjustments. Outside unusual periods of market activity, automation is also typically used for normal to smaller ticket sizes. As one member remarked, intending to electronify their bond business and coming from an equities background, they had underestimated both the complexity of bond products and the problem of liquidity.

Data

A key requirement for the continued development of e-trading and automation is harnessing the ever-increasing amount of usable data available on one system. Data aggregation, however, involves the sourcing of information from multiple providers and presenting it in a consistent format, which is often not defined. 'Price', for example could indicate composite price (an average price based on quotes aggregated across various dealers), calculated but not executable, indicative, semi-firm, or other pricing points used for transaction cost analysis (TCA), among others. Various providers also combine trade histories, dealer contributions and comparable securities data to make available trademarked pricing insights. Due to fragmentation of all market data across providers, a greater ability to aggregate and grade pricing data – what is indicative or firm for example – would benefit participants. ICMA's 2021 *Industry guide to definitions and best practice for bond pricing distribution* publication provides a foundation for participants to distinguish been pricing terms such as run, market-run, axe, streaming, and executable.

Looking at industry trends over the last 12 to 18 months it is evident that data aggregation analytics and distribution capabilities remain core drivers for mergers and partnerships. Multiple partnerships with data providers and third-party analytics services with trading venues and order/execution management Systems (O/EMS) were announced. Those data and analytics vendors forming collaborative ventures varied from global service providers to others with less than 50 employees, showing potential for further integration of best-in-class analytics independent of company size.

The use of AI, ML and other advanced analytics capabilities leveraging data still seem not to be prevalent in fixed income, compared to other asset classes such as equities or FX. AI for algo trading still appears limited to pre-programmed execution rules for low volume, liquid trades. AI, however, was noted as a valuable tool allowing users to rebuild synthetic inventories, to infer positions in a given bond with higher probabilities of success. There is also evidence of AI specialist vendors collaborating with bond trading venues, leveraging AI for building pre-trade reference prices for corporate bonds.

Electronic communication messaging standards

Data standardisation and efforts toward harmonisation of electronic communications protocols featured through discussions among ETC members. The FIX protocol enables firms to exchange trade information electronically, though commonly customised by individual firms – a uniform implementation does not exist. Different standards inhibit growth, and improvements in electronic methods to communicate will improve trading insights and lower post-trade costs. The growing commercialisation of data generated by trading is expected to continue to drive requirements for codified, standardised data for value extraction.

Partnerships across the fixed income market over the last 12 months show demand for workflow and connectivity product enhancements. Multiple O/EMS's continue their expansion in connecting to additional venues. Given the type of connectivity offered by O/EMS's via cloud, we may expect greater use of the term 'TaaS' (Trading as a Service). Larger technology providers also look to be increasingly connecting with third parties to deliver greater optionality to users within a streamlined interface.

Trading protocols

The evolution of bond portfolio trading featured as another core theme. Portfolio trading consists of trading a basket of securities (varied sizes, maturity, and liquidity) in one single transaction with one counterparty. Pricing on a portfolio basis was initially seen as an effective strategy to execute a high number of trades that would otherwise be individually processed via RFQ. However, many ETC members seemed sceptical of the trend towards bundling more illiquid ISINs into portfolios with tight prices. Additional concerns were raised around the consolidation of liquidity in a smaller number of institutions, raising uncertainty on the sustainability of the portfolio trading execution method looking ahead.

Various protocols are offered by trading venues and O/EMS's for electronic cash bond trading, as highlighted within ICMA's ETD. Per *ICMA's 3rd study on the state of the European investment grade corporate bond secondary market* (March 2020), selective or multiple request for quote (RFQ) is the most commonly used between buy-side and buy-side. However, market volatility in the preceding 18 months saw many participants resorting to voice trading to avoid the risk of pricing across electronic platforms, as well as a slight shift from the use of multiple RFQ to anonymous RFQ.

In terms of other protocols, some members noted that they would like to see more trading via request for market (RFM), ie two-way prices, which may provide better prices when direction is hidden – some platforms are facilitating this in the emerging markets space. Auctions were also mentioned as a means of consolidating liquidity pools within designated time slots for a variety of ticket sizes. Although a lot of trading volume has moved from over the phone to electronic platforms, especially in the sovereign rates space with more sophisticated algo pricing, opportunities remain for a hybrid model that would bridge liquidity between voice-brokers and e-trading platforms. Prospects for the growth of exchange operated central limit order book (CLOB) trading, usually for small, liquid instruments, remain to be seen.

All-to-all trading remains mixed in terms of market adoption and support. All-to-all trading connects all participants, sell-side and buy-side, (usually anonymously) and allows all firms on a venue to request quotes. Some buy-side firms and trading venues support the growth of proactive price-making from all-to-all connectivity. Sell-side firms welcome any technology to facilitate less-liquid bonds moving from seller to buyer, though tended to flag that the illiquid nature of many bonds requires bank balance sheets for capital provisions. Additionally, it seems that trading via all-to-all protocols still only accounts for a small proportion of all trading and any percentage increases are only in the single digits. As one member explains, asset managers are still reliant on large banks providing liquidity.

Within this context, there is also evidence of increased collaboration among the buy-side with data sharing platforms to pool and distribute transaction data, thereby increasing transparency. At the same time, respondents reflected on the positive impact of a bond consolidated tape on transparency, bringing information on executed prices to facilitate pricing negotiation – whether it be all-to-all or bilateral.

Conclusions

A common theme of ever-increasing importance for electronic cash bond trading is data. Increasing capabilities to collect and leverage data are a key requirement for the growth of bond e-trading and automation. This naturally leads to additional emphasis on the role and development of electronic communication messaging standards. Portfolio trading is a notable development and offers a range of benefits, but the longer-term sustainability of this execution method remains uncertain. ETC members also discussed the evolution of various electronic trading protocols available on venues and via O/EMS' such as the potential for further use of RFM, though noted many participants resorted to voice trading at the height of the COVID pandemic and ensuing market turmoil.

For further reading, the IOSCO Affiliate Members Consultative Committee (AMCC) Bond Market Liquidity Working Party (BMLWP), recently released its report on corporate bond market microstructures & stakeholder behaviours. The AMCC BMLWP, chaired by ICMA, based the report on an industry-wide survey intended to complement the work being undertaken by the IOSCO FSEG on corporate bond market structures and liquidity provision, looking at market microstructures and participant behaviour.

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