

MTS MidPrice:

Automate execution at BV Composite Mid on MTS

One of the biggest challenges for market makers in sovereign debt is covering risk quickly, efficiently and without information leakage.

Challenging times, limited solutions

For many banks, various factors have radically changed the way in which they conduct their market making activities in European sovereign debt. This has left them with conflicting objectives:

- ▶ They are required to make prices to support the secondary market liquidity provision needs of debt management offices (DMOs)...
- ▶ ...but they do not wish to consume balance sheet unnecessarily, nor be hit or lifted on somebody else's terms.

Conventional means of covering positions resulting from market making activity are inefficient:

- ▶ Using cash bonds: both trading on the regular order book and using more traditional trading methods risk information leakage and negative slippage. (The alternative of laying off to clients is not a practical option unless the bank does very large volumes of client business.)
- ▶ Futures: potentially imprecise hedge for actual exposure.

This problem applies across the board, but at present particularly affects two groups:

- ▶ Banks that have limited balance sheet capacity available for sovereign debt market making and so must have fast inventory turnover.
- ▶ Traders covering inflation and other markets where bid/offer spreads are wide.

How it works

Trading at BV Composite Mid gives traders a practical alternative by providing a highly automated market with firm pricing, with the key distinction that participants' intent is hidden. MidPrice is a separate order book where traders can send executable orders to buy or sell at their own mid-level or better.

Hidden matching occurs at the BondVision Composite MidPrice (i.e. BV Composite Mid) when an opposite active order exists from another counterparty.

Only the BV Composite Mid is visible in the orderbook and this is highlighted (see orange highlight in Figure 1) whenever there is an order to buy or sell at this level. No individual order details are visible in the order book, so it is impossible for other participants to see the size or side of any orders placed.

MTS MidPrice is already supported by the latest software versions of leading MTS ISVs. Configuring MidPrice streaming is therefore simple to set up and price updates are completely automated.

Why use it?

Discretion: a critical difference between MTS MidPrice and the regular order book is that on MidPrice a trader's pre-trade activity is completely invisible to other participants, so there is no risk of information leakage. All that is visible is the MTS MidPrice for each issue, which becomes highlighted whenever there is an order to buy or sell (see orange highlight in Figure 1) at that MidPrice.

Control: Any trades executed on the MTS MidPrice order book will be on the trader's terms, as opposed to an aggressor's and banks can now contribute their own MidPrice automatically. While matching will always occur at the BV Composite Mid, the bank will always execute at their level or better.

Flexibility: the trader's desired MidPrice can still be posted anonymously in the MidPrice book and will immediately become tradable (highlighted as in Figure 1) should the MTS MidPrice hit the same level.

Hedges for any trades executed on the regular book can be set up to post automatically to the MTS MidPrice book and be managed automatically once there. There is also a good chance of obtaining a perfect hedging match on MTS MidPrice, without any of the information leakage risk and additional spread cost of using the regular book. Even if that isn't possible, a far more accurate hedge than just using futures should still be achievable.

Positive slippage: by posting blind on the MTS MidPrice book close to the current MTS MidPrice (on the appropriate side), traders have the opportunity of picking up positive slippage on their trades.

Immediacy: for urgent trades, traders can simply post in the MTS MidPrice book at the current displayed MTS MidPrice for immediate execution. This is a far better option than the alternative of aggressing on the regular book, which results in information leakage plus having to incur the cost of crossing the spread.

MTS MidPrice - Figure 1

MTS MidPrice

38	Ticker	Cpn	Maturity	PX	Strategy	Bench.	Prc	Yld	MTS MidPrice	Status	Price MP	Price Spread MP	Yield Spread MP	VQty	Side
2	DBR	2.500	04/01/21	●	TED-Spread	71.66	102.330	0.402	102.336	on	102.337	0.6	1.0	10	Sell
3	DBR	1.750	04/07/22	●	TED-Spread	80.20	103.580	0.513	103.590	on	103.592	1.1	1.0	10	Sell
4	SPGB	0.050	31/01/21	●	Curve Spread	85.78	104.588	0.622	104.5825	on	104.570	1.7	1.0	10	Buy
5	PORTB	0	17/09/21	●	Curve Spread	-3.6	105.336	0.696	105.400	on	105.315	2.2	1.0	10	Buy
6	PGB	4.950	25/10/23	●	Curve Spread	-13.9	105.890	0.712	105.890	on	105.895	0.5	0.2	10	Sell
7	BOT	6M	30/04/21	●	Curve Spread	-15.8	104.155	0.733	104.183	on	104.185	2.8	1.0	10	Sell
8	BTPS	0.450	01/06/21	●	Curve Spread	-12.9	105.069	0.843	105.0650	on	105.065	0.3	0.1	10	Buy
9	BTPS	1.450	15/05/25	●	Curve Spread	-17.0	108.230	0.920	108.25	on	108.27	3.7	1.0	10	Sell

● The MidPrice is highlighted when there is an order to buy or sell at mid and can be aggressed to attempt matching

● You can manage the MidPrice as per standard quoting features including:

- Status (On/Off)
- Level Contributed
- Spread from your Mid (cts/bps)
- Quantity
- Side (Buy/Sell)

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