

Questions & answers

Taking the pulse of innovation in credit markets for 2016

Simon Linwood, Head of Sell-Side Accounts at MTS shares his thoughts on the key drivers of change in today's credit markets, the challenges and opportunities market participants face sourcing liquidity and how MTS is developing innovative ways to facilitate efficient pre-trade price discovery and trade execution on electronic venues.

Q1 What trends are currently characterising the credit markets?

We are seeing record levels of corporate bond issuance year-on-year in Europe and the US; a trend that has stimulated significant secondary credit market activity.* Government monetary policy, a prolonged low interest rate environment and strong deal flow of bond issuance have all contributed to record volumes. However, in Europe, the ECB's decision to extend QE to EUR 80bn a month and also to include corporate debt has further raised concerns around liquidity. Moreover, Brexit and the uncertainty around markets and the geo-political landscape as a whole have further compounded liquidity fears, with market participants, exchanges and electronic market operators all looking at the implications of UK domestic authorisation and the passport of activities into the EEA member states.'

Spreads across the capital structure have continued to tighten as a result of the booming primary market and efforts by the ECB and other central banks around the world to encourage economic growth by keeping borrowing costs low. This has lowered the perceived credit risk of buying corporate debt, encouraging investors to turn away from the safe haven of government debt resulting in a fresh wave of issuance in structures such as Hybrids, AT1's and Co-Co's.

A side effect of this particular type of monetary policy is that buy-side investors are being forced into buying longer dated paper and extending the duration of their portfolios, as central bank bond buying plans have lowered the returns available from much of the credit market. In addition, intervention from governments and central banks has meant that credit, which traditionally has traded purely on fundamentals, is now beginning to be impacted by macro economic events.

Meanwhile at an operational level, electronic trading continues to permeate US and European credit markets, addressing regulatory and market appetite for increased trading transparency and efficiency.

On the regulatory front, regulations such as Basel III and various new capital requirements mean it is now very expensive for banks to carry inventories for corporate debt. As a result, the ability of sell-side banks to warehouse bonds has been severely impacted, which in turn reduces the availability of bond liquidity further. Concerns around the Central Securities Depository Regulation (CSDR) and mandatory buy-ins are also cause for huge concern within the bank community.

*International Capital Markets Association (ICMA), Remaking the corporate bond market: p 3, July, 2016



Q2 What challenges/opportunities are market participants currently facing?

One of the main challenges facing participants is how to improve liquidity when corporate bond markets remain incredibly fragmented, with companies taking advantage of central bank programmes and issuing an increasing number of bonds in multiple maturities, currencies and structures. Facilitating cross-border flows has already proved an effective way of addressing a number of challenges facing market participants in the credit markets, specifically the availability of executable liquidity.

By connecting counterparties in the US, Europe and beyond, the market can begin to reverse a tide of liquidity fragmentation by widening the network of available counterparties – all in the pursuit of effective price discovery and execution on electronic venues. As markets continue to merge, effectively diversifying networks of counterparties, this also enhances the availability of credit instruments, delivering greater trading opportunities to new and existing market participants.

A major issue buy-side firms currently face is that they do not have enough pre-trade information to know which banks hold the corporate bonds they are seeking to trade. This process has traditionally been unsophisticated – for example firms may ask German banks for German corporate bonds and Spanish banks for Spanish corporate bonds. At the same time, new regulation has impacted balance sheet capacity and internal distribution, and has resulted in banks cutting down on the number of bonds they are willing to price and the number of RFQs to which they will respond.

Most fund managers receive tens of thousands of information points from their dealers each day and simply do not have the capacity or systems to cope with such a high volume of information flow. As a result, buy-side firms face the conundrum of choosing which dealers to approach and how much information they are willing to give away when trying to trade large blocks. Issuing multiple RFQs may help determine the best market rate, but the relationship between the banks and the marketplace deteriorate as banks will see their hit ratios fall. On the other hand, safeguarding information leakage by only requesting prices from a handful of dealers often means missing out on the best market price for a particular security. The issue is only amplified for traders wishing to move large block trades without artificially driving up prices.

Q3 How does the market free up and unlock this liquidity?

Very few asset managers have gone through the pain of developing proper systems that give them a comprehensive view of the market that would allow them to leverage this latent liquidity. MTS B2SCAN is a solution to this challenge. It is a web-based pre-trade information tool that allows clients to identify the banks that hold the bonds and then trade on MTS BondVision, which is regulated by both UK and continental Europe authorities.

Banks benefit from the ability to shift bonds held on their inventory, increasing profitability and improving distribution to the buy-side. In an environment where the traditional bank sales relationship model is being phased out, this is also an important client growth and retention tool and is designed to re-intermediate the banks with their clients.

The price discovery tool enables buy-side firms to access bond inventories from a network of over 30 banks and trade on MTS BondVision, a regulated multi dealer-to-client trading venue. To aid the price discovery process, the technology provides market participants with a comprehensive overview of real-time market liquidity on up to 20,000 axes daily, enabling buy-side members to locate an appropriate counterparty efficiently.



Q4 What changes are credit market participants making to meet the increased focus on risk and compliance?

Participants are placing more emphasis than ever before on choosing trading venues that are secure, trusted and regulated. As regulations continue to evolve, we have seen market participants set best practice in terms of risk management and compliance by moving more and more of their credit business onto transparent, regulated electronic markets.

MTS has been operating regulated and transparent electronic markets for fixed income products since 1988. Our efforts to optimise liquidity and equip traders with the technology and market data they require to prosper in today's markets have positioned us as the credit platform of choice for the new regulatory and compliance landscape. MTS BondVision platforms for example, deliver users with cross-border access to credit markets and are regulated by the Bank of Italy and Consob, the FCA and by FINRA and SEC in the various jurisdictions in which it operates.

Q5 How are trading venues adapting to reflect the changing credit market structure?

Trading venues are responding to the structural changes to the credit market with innovative technology solutions. As participation in fixed income markets continues to rise, institutions are continuing to demand global access to a wide network of market makers and takers. On MTS BondVision, our RFQ execution model connects traders to over 30 global and regional dealers, ensuring access to the best rates available for round-lot to block size trading on a range of credit instruments. Meanwhile, MTS BondsPro provides the perfect model for odd-lot to round-lot trading, enabling us to cater for all trade sizes and offer differing protocols appropriate to each size.

To enhance MTS BondVision further, we have integrated MTS B2SCAN within the MTS BondVision architecture, effectively streamlining the price discovery and trade execution process, whilst allowing users to benefit from trading on a fully regulated venue and access to straight through processing. MTS B2SCAN enables traders to search for a specific credit instrument, request a quote from the bank holding the inventory and execute the trade directly on MTS BondVision. This is a very significant tool in a market battling liquidity challenges.

We have also developed MTS BondVision to broaden access between US and European markets, allowing both dealers and buy-side firms to access global liquidity pools. Facilitating cross-border flows is now central to our strategy.

With the blurring of lines between the buy- and sell-side continuing, MTS has pioneered the all-to-all model on our MTS BondsPro platform as a method of boosting liquidity by enabling all participants to act as either price provider or price taker. As part of an initiative to further bolster liquidity, we allow market participants who post prices on our all-to-all venue to trade for free, reducing trading costs significantly. The platform brings a new, more innovative option to the table by supplementing the user's current trading routes, rather than replacing them. This focus on simplicity has been complemented through technology investment, ensuring a healthy pipeline of product and functionality enhancements for new and existing users and ultimately facilitating quick, effective on-boarding for new market entrants. MTS BondsPro is specifically catered to trading in all sizes and provides users with the relevant trade execution protocol based on trade size.

In terms of recent technology enhancements on the platform, the introduction of an HTML 5-based graphical user interface (GUI) was significant. The technology facilitates pure web-based trading on our platform with zero software requirements, effectively reducing deployment times and condensing the trading workflow from price discovery to execution. Over the last few years we have also focused on connectivity with Order and Execution Management Systems (OMS & EMS), the most recent being Bloomberg TSOX.



About MTS

MTS Group facilitates a number of regulated electronic fixed income markets across Europe and the US that are managed centrally to ensure optimum levels of global harmonisation and consistency. Over 500 unique counterparties trade an average volume of €100 billion each day on these platforms.

The individual companies within the MTS Group are regulated by financial services regulators in a number of European jurisdictions, including Financial Conduct Authority (FCA), Italian Ministry of Finance, Banca d'Italia, Consob, Autorité des Marchés Financiers (AMF), and in the United States by FINRA and SEC.

MTS Cash is a comprehensive and professional cash securities trading environment for the interdealer marketplace. MTS cash includes several domestic markets regulated in different jurisdictions enabling primary dealers to access unparalleled liquidity, transparency and coverage.

MTS Repo provides an order-driven market for the electronic transaction of repo agreements and buy/sellbacks in Italy.

MTS BondVision is a trusted and efficient multi-dealer-to-client electronic bond trading platform, delivering exceptional access for institutional investors direct to market makers. MTS BondVision is accessible in Europe from the Italian and the UK legal entities and in the US through the US legal entity of MTS Group. On the BondVision platform, MTS Group provides institutional investors with real-time pricing and the ability to trade with the major dealers.

MTS Credit provides a variety of electronic execution methods for a wide range of multi-currency non-government bonds, including covered, SSA, corporate and financial bonds. MTS Credit is composed of financial instruments available to trade on both BondVision and MTS Prime.

MTS Swaps leverages existing MTS Group distribution technology to deliver immediate access to a diverse range of liquidity providers through your chosen prime banks.

MTS Data is sourced directly and exclusively from the MTS interdealer market and includes benchmark real-time data, reference data, reference prices and historical data, providing the benchmark data source on the fixed income market.

FTSE MTS Indices are operated by FTSE TMX Global Debt Capital Markets, in which MTS has a minority stake. They provide independent, transparent, real-time and tradable Eurozone fixed income indices, based on tradable prices from MTS. FTSE MTS indices are tracked by (and can be traded via) around 40 ETFs in addition to numerous structured products.

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