TRENDS IN FIXED INCOME TRADING 2014

The Evolution of the Market Structure for Fixed Income Trading

In 2014, many investment banks are increasing the amount of **technology** used to trade bonds – corporate and sovereign – and interest rates swaps. The new technology solutions are being implemented by the banks to reduce the overall costs associated with running fixed income trading businesses. For example, since 2009, the costs of bonds trading for the leading dealers increased dramatically after the G-20 nations agreed to implement new protocols requiring banks to hold larger capital reserves to offset the risks associated with warehousing long-term fixed income cash flows. As bank bonds **balance sheets shrank** in response to regulatory mandates, it became necessary for many dealers to more efficiently manage a smaller number of the securities they hold for trading purposes.

GreySpark forecasts that sellside efforts to develop e-trading business models for bonds trading will evolve to match a new set of industry practices for **balance sheet efficiency**. Balance sheet efficiency imperatives are seen in many banks as the cost associated with new investments in technology solutions that allow for more sophisticated fixed income dealing analytics on a trade-by-trade basis, especially in corporate bonds trading. For swaps, GreySpark anticipates that the majority of OTC derivatives volumes will electronify by 2016 to match current levels of e-trading **overcapacity** for all but the most complex exotic IRS instruments as EU and US regulations mandating new levels of exchange-traded transparency for the instruments take hold.

Bonds Electronic Trading

	2007 – 2014	2014 – 2016
Voice	Bonds trading remains predominantly OTC, especially for corporate bonds, as the buyside slowly adjusts to sellside e-commerce fixed income dealing imperatives.	Voice trading capacity on the buyside and sellside will shrink dramatically as new bonds crossing engines and the standardisation of the majority of OTC derivatives pushes more fixed income liquidity onto regulated markets platforms.
Multi-Dealer Platforms	RFQ functionality for on-the-run corporate bonds, liquid sovereign bonds and for IRS trading is capturing increasing numbers of market participants.	Multi-dealer platforms for swaps trading will benefit significantly from the standardisation of the majority of OTC contracts, and they will be incentivised to innovate to capture more market share in the form of liquidity.
All-to-All Venues	Exchange-like, all-to-all platforms wherein buyside firms can meet each other to swap fixed income liquidity streams are in their infancy and are prone to failure without sellside support.	All-to-All platforms for the buyside will emerge, mimicking features of dealer-to-dealer platforms for corporate and sovereign bonds liquidity.
Exchanges	Market-leading exchange platforms are broadening their base of swaps and swaps futures product offerings in an effort to remain relevant as dynamic new SEF platforms emerge.	Swaps liquidity on exchanges will dwindle as SEFs compete with traditional exchanges for a diversity of product offerings and market share; meanwhile, dealer-to-dealer platforms for sovereign bonds will compete with sellside efforts to internalise corporate bonds liquidity in a balance-sheet constrained environment.
Inter-Dealer Brokers	Inter-dealer brokers remain relevant in IRS markets where OTC trading is prevalent, and in the corporate bonds space where efficiently matching buyers and sellers remains difficult for all but the most sophisticated banks.	Inter-dealer brokers will struggle to remain relevant in markets for swaps and bonds as automated trading operations negate the need for extensive price discovery on a trade-by-trade basis

Banks Must Choose a Fixed Income Business Model

The Characteristics of Sellside Fixed Income Business Models

This report competitively assesses four categories of fixed income dealers. concluding that:

Niche Specialists

Using market knowledge and analytics, these banks must focus on specific products that can attract premium pricing to drive fixed income business profitability. Being a niche specialist requires functional innovation and experience.

Flow Houses

These banks require a critical mass of fixed income volume to drive profitability. For these banks, continuous and significant investment in technology is a prerequisite.

Risk Takers

These banks rely on robust market risk controls to maximise returns from the available balance sheet. Being a risk-taker requires clear strategies and advanced sales-trading technology.

Prime Brokers

These banks have strong execution capabilities to support their prime brokerage business. They must provide financing capabilities for clients to maximise the bank's fees revenue. Being a prime broker in the fixed income market requires strong client risk management assessment capabilities.

For more information, please go to:
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