



A State Street Company

T A B B

F O R U M

W H E R E C A P I T A L M A R K E T S S P E A K

How an OEMS Bridges the Gap Between Traditional and Electronic Fixed Income Market Structure

The fixed income markets are undergoing a transformation, and dealers, buy-side firms and the growing number of electronic trading systems each face both unique and interrelated problems, not the least of which is liquidity. Technology vendors have responded by offering a new generation of integrated order and execution management systems that help buy-side firms adapt to the changing fixed income landscape by centralizing connectivity to dealers and trading systems on a single desktop and providing critical trade decision support.

Fixed income market structure can be viewed as a three-legged stool, with legs consisting of dealers, buy-side firms, and the growing number of ECN, MTFs and ATSs – collectively, “electronic trading systems.” Each leg faces both unique and interrelated problems, and solving any of these problems can stabilize and strengthen the other legs.

Dealers, despite the well-publicized reduction in their fixed income inventories, are still the go-to for buy-side firms looking to trade large volume. Motivated by cost pressures, client expectations and regulatory impacts, dealer business models are being disrupted and retooled as they look for better ways to interact with buy-side firms.

The proliferation of **electronic trading systems** has been driven by the perceived opportunity to capture buy-side order flow as dealers retrenched. Predicated on the belief that buy-side firms would embrace electronic trading, these startups have met with mixed success by offering alternatives to the traditional RFQ model and providing platforms for transacting far smaller average trade volumes than dealers typically support. Ironically, this benefits only a portion of the overall fixed income market, primarily IG, HY and rates trading in US and EMEA. Even with 90-plus venues now operating, the transition to e-trading has been slower than expected. Both the number of markets and execution models has increased substantially. But these venues need to stand out in an increasingly crowded field in order to attract sufficient volume.

Buy-side firms have absorbed massive corporate credit issuance over the past three years. Their concerns focus on which execution venues will provide sufficient liquidity during adverse market events and how to satisfy investor and regulatory demands for greater insight into execution quality. Although e-trading offers fixed income desks new opportunities to access liquidity and pricing information, traders don't have time to explore each and every trading venue before making a trade decision, nor are they looking for yet another system to take up space on their desktops. Unlike equities, fixed income markets don't follow a publicly transparent model, and many trades still require manual phone conversations to facilitate liquidity discovery and price negotiation. Phone-based trading isn't likely to disappear soon, if ever.

Technology vendors have responded by offering a new generation of integrated order and execution management systems (OEMS). This article examines how an OEMS helps buy-side firms adapt to the changing fixed income landscape by centralizing connectivity to dealers and trading systems on a single desktop and providing critical trade decision support via a comprehensive database of trade, order and market history. While OEMS adoption is proving to be a competitive differentiator for the buy-side, it also benefits the entire fixed income community by democratizing access to buy-side order flow for liquidity providers, from the largest dealer to the latest startup ATS offering an innovative new execution model.

Solving the Connectivity Quandary

An OEMS provides connectivity to all venues and dealers and aggregates quote and inventory data on a centralized platform. A single, consistent user interface that is “re-usable” across multiple trading models ensures that buy-side traders need to learn only one interface, and delivers a transparent and broad view of inventory and liquidity.

Technology vendors perform the heavy lifting by building and maintaining FIX interfaces to electronic execution venues such as KCG Bondpoint and UBS Bondport, and continuously adding new venues to the OEMS. Additional vendor-supported interfaces let dealers send inventory and indicative pricing directly to the OEMS trading blotter. Buy-side firms save on integration and support costs, and benefit from more efficient workflows, greater market transparency, and detailed audit trails. By helping traders break up large orders to reach all available market liquidity, the OEMS is supporting the evolution towards smaller trade sizes.

Data-driven decision support

Both electronic and voice-based orders and trades generate significant amounts of valuable data that can be leveraged to improve fixed income trade execution and liquidity access. Driven in part by regulatory and client demands for greater transparency and auditability, OEMS vendors are capturing and archiving a comprehensive picture of the market at the time of the trade, including price, quote, inventory axes and counterparty data.

From a buy-side perspective, the OEMS has the key building blocks required to populate a database with trade and order data. The database then provides fixed income traders with salient data for making better informed trading decisions with their traditional counterparties.

The true value of a fixed income OEMS lies not only in the breadth of connectivity to trading venues and depth of archived trade history, but rather the flexibility to accommodate for the absence of data. For thinly traded markets, the ability to illuminate one or two esoteric data points may be most valuable. Critical data points include which dealers have historically provided the best quotes/inventory, and which dealers have most frequently acted as counterparties for this issuer or industry.

Pre-trade, the OEMS displays inventory, quotes and streaming executable prices. It also incorporates streaming time and sales data from TRACE, MSRB, and the (eventual) trade feed designated by MiFID II. The latter feeds are used to enrich order and trade history prior to archiving in the OEMS database and provide traders with increasingly critical visibility into market structure and trade activity at the point of execution.

A solid foundation for TCA

Data enrichment adds significant value to the trade and order information archived in the OEMS. Appropriate reference prices and calculation options are applied to provide a context for each trade's execution quality. Different data sources can be incorporated in the OEMS, based on an instrument's trade history, sector and liquidity profile.

This analysis is then archived in the OEMS database and can be accessed whenever that name is traded in the future. The enriched trade and order data facilitates transparent, data-driven comparisons between trading counterparties and provides a solid foundation for implementing fixed income TCA.

Full visibility across the trade lifecycle

The most important innovation provided by the next-generation OEMS is the ability to make more informed order routing decisions. While e-trading is gaining traction, significant fixed income trade volume is still transacted manually. The data collected in the OEMS helps traders understand the inflection point between trading electronically versus manually. The OEMS now provides visibility into the full trade lifecycle for all orders, not merely a portion of the orders that most vendors and venues are limited to.

Technological innovation benefits the entire fixed income community

Adoption of the next-generation OEMS has become mandatory for buy-side firms navigating the radically altered fixed income landscape. But in a larger sense, the OEMS is an important technological innovation that addresses the significant problems facing dealers and emerging ATs. Greater visibility into execution quality and streamlined connectivity will ultimately benefit the entire fixed income community by rewarding the execution venues and dealers that offer consistently better execution than their competitors.

The material presented is for informational purposes only. The views expressed in this material are the views of the author, and are subject to change based on market and other conditions and factors, moreover, they do not necessarily represent the official views of Charles River Development and/or State Street Corporation and its affiliates.

“In the new-generation OEMS, the fixed-income workstation has been completely redesigned to display order reception, real-time market data, historical transactions, dealer inventory, order book liquidity and trade execution on the same screen. Trade history and dealer inventory are both auto-matched to orders, which makes a real difference to buy-side traders who currently have to switch from one system to another.”

–Fabien Oreve, Candriam Investors Group



A State Street Company

CHARLES RIVER DEVELOPMENT, A STATE STREET COMPANY

Charles River enables sound and efficient investing across all asset classes. Investment firms in more than 40 countries use Charles River IMS to manage more than US\$25 Trillion in assets in the institutional investment, wealth management and hedge fund industries. Our Software as a Service-based solution (SaaS) is designed to automate and simplify investment management on a single platform – from portfolio management and risk analytics through trading and post-trade settlement, with integrated compliance and managed data throughout. Headquartered in Burlington, Massachusetts, we support clients globally with more than 750 employees in 11 regional offices.

CRD.COM