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06 January 2016

## Confessions of an All-to-All Trading Advocate

*Despite the benefits offered by all-to-all and other electronic trading platforms, statistics show that most corporate bond trades continue to be negotiated between a dealer and an institutional investor via phone or chat. Why hasn't electronic trading captured a greater share of corporate bond trading volume, and what are the characteristics of an alternative electronic trading environment that would be most appealing to both buy-side and sell-side participants? Even an all-to-all advocate was surprised by the answers.*

Given my role in introducing and operating the first electronic platform for all-to-all corporate bond trading in the 1990s, it's no surprise that I have long advocated the benefits of this trading model for certain fixed income securities. The all-to-all protocol provides compelling transparency and efficiency benefits for trading issues for which a dedicated market maker isn't required to sustain reliable liquidity.

Despite the benefits offered by all-to-all and other electronic trading platforms, however, statistics show that most corporate bond trades continue to be negotiated between a dealer and an institutional investor via phone or chat. Greenwich Associates' latest report estimates that only 20% of investment-grade and 6% of high-yield transaction volume is traded electronically by institutional investors in the U.S. So why hasn't electronic trading captured a greater share of corporate bond trading volume?

To answer that question, we sponsored independent research seeking to hear the "Voice of the Market" by polling an array of buy-side and sell-side participants regarding their use and assessment of current fixed income trading platforms. That research indicated participant concerns regarding the consequences of disintermediating dealers, high fees and costs, small transaction sizes, and potential information leakage, among others.

We also sponsored research to identify the features and characteristics of an alternative electronic trading environment that would be most appealing to both buy-side and sell-side participants. That research revealed broad and material interest in a digital communication facility that:

1. Preserves and enhances the traditional market roles and relationships of dealers and investors.
2. Enables dealers to again source on-demand liquidity, by deploying the necessary market making inventory.
3. Solves for dealers the capital costs and constraints limiting their ability to hold inventory.
4. Facilitates confidential one-to-one, one-to-selected and one-to-all communication and interaction among dealers and investors.
5. Restores the single-name CDS market and charges minimal (preferably no) transaction fees.
6. Provides accurate, continually updating reference pricing for all subject and comparable issues.

I confess that the results of the research caused me, despite my advocacy of all-to-all trading, to realize that a dealer-centric trading environment should continue to be the cornerstone of the fixed income market. That is, if that environment is “electronic” and one in which dealers and investors can confidentially interact, investors can profitably provide liquidity resources to and through dealers, and all participants can materially reduce their trading costs.

It is against this backdrop that my DelphX colleagues and I proposed and developed the utility of ["Cached Inventory."](#) which provides a versatile solution to the current liquidity issue by allowing dealers to negotiate access to inventory held at buy-side firms in exchange for preferential pricing and other incentives.

Here's how it works: A dealer and investor negotiate the terms of a future transaction in which the dealer will buy or sell a specified amount of a security at an agreed price within a set time period. The dealer and investor then agree to place the pending transaction in a secure cache administered by DelphX. The dealer can then release some or all of the pending transaction during the agreed period – facilitating its ability to again source immediate OTC market liquidity.

Like any innovation, maturation and adoption compound its benefits to all users. Over time, adoption of Cached Inventory will foster unprecedented data for corporate bond and single-name CDS pricing and analytics. The aggregation of quotes directly from dealers across the system will provide access to definitive indexes and pricing curves that magnify the depth and breadth of the book, enable more efficient and strategic trading, and foster greater confidence among all participants. This ultimately ushers in new participants and expands the market opportunity for all.

While we don't claim that an innovation such as Cached Inventory is the complete solution, we are convinced that it efficiently addresses a vexing market problem – a shortage of dealer-deployable inventory and a diminishing bilateral CDS market. We are also convinced that accurately hearing and heeding the Voice of the Market produces the most effective and enduring solutions.

# Comments |

6 Comments to "Confessions of an All-to-All Trading Advocate":



**crooklyn**

07 January 2016

" Here's how it works: A dealer and investor negotiate the terms of a future transaction in which the dealer will buy or sell a specified amount of a security at an agreed price within a set time period. The dealer and investor then agree to place the pending transaction in a secure cache administered by DelphX. "

Am I missing something here? Isn't this what occurs via phone presently? If using this DelphX method, investors will make the "set time period" 1 hour, and also what if market conditions change in the first 5 minutes of the "set time period" ? Can the investor change their price or are they committed to the 1 hour time period? Again ...am I missing something here?



**Ifondren**

08 January 2016

Crooklyn - Thank you for your comment and questions. The DelphX network is designed to enable dealers and investors to negotiate in any manner they elect on a case-by-case basis, be it via our digital communication environment (in which participants can conduct many negotiations simultaneously), via phone (in which their conversations are more sequential in nature) or any combination thereof. We don't charge transaction fees, so we have no incentive to limit the interaction of prospective counterparties in any way.

The "set time period" of each cache is solely determined by the prospective counterparties of the pending trade, and can be set to virtually any length of time. Feedback from dealers and investors, however, indicates that most cache-periods will be set to range from 30 to 90 days in duration (though caches in which pending single-name CDS contracts are held will likely be set to expire concurrently with the maturity of the underlying cash bond).

The cache counterparties also determine the metric(s) of the pending transaction's pricing over time, which may be set at a fixed USD price or (more likely) at a fixed spread off a specified reference security (say an on-the-run U.S. Treasury), etc.

Thanks again for your questions.



**paulconstantino**

08 January 2016

Larry, can you explain how the cache works in a bit more detail? It appears from your explanation that a dealer would need to commit to a level on a trade and thus would necessarily need to include this exposure in their CCAR calculations (or not is this a compliance issue)...



**Ifondren**

08 January 2016

Paul - Thanks for your interest and question. The caching process enables a dealer and an investor to confidentially negotiate the terms of a transaction within the DelphX network, and then optionally suspend that pending trade (rather than proceed to execute it), and agree further as to the terms of the "Cache" into which it will held and administered by DelphX.

The operative word in that prior sentence being "pending", as the agreed-but-not-executed transaction will not become a trade unless and until the dealer exercises its unilateral right to release the Cache (in whole or agreed increments) to allow the released portion of the pending trade to be executed.

As the dealer is not obligated in any way to release the Cache, execute the pending trade or commit to execute any portion thereof, the dealer incurs no liability, exposure in their CCAR calculation or adverse balance sheet impact. Moreover, no reporting to TRACE would be appropriate either, as the pending transaction has yet to be (and may never be) executed. Thanks.



**paulconstantino**

08 January 2016

Thanks Larry, so seems like a variation of RFQ, bid wanted, or IOI...



**Ifondren**

08 January 2016

Yes, all such protocols are available for communication and staging of both active and latent interests and liquidity for cash instruments and single-name CDS contracts. Participants can also schedule private ad hoc sessions and single-price auctions, and the integrated "Quix" messaging facilitates most any form of transaction-focused communication between dealers and investors.