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The Inside Market

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Not Just Another Data Source

If you've been keeping a close eye on innovation initiatives in the corporate bond market, things have been a bit stagnant. Dominant solution providers have focused on improving ideas that have already been proven to be commercially viable, so many of the recent products launched in the corporate bond market have been different versions of the same idea. This makes strategic sense: *If ABC platform is successfully making money by offering solution XYZ, then why don't we build a better XYZ and take market share by lowering fees?* As a result, the corporate bond market now has multiple iterations of all-to-all trading, odd lot compressions, evaluated/AI pricing tools and portfolio trading solutions.

So when was the last real transformative technology innovation in the corporate bond market?

Recently, it was announced that the BlackRock Aladdin OMS has integrated BondCliQ's US corporate bond pricing data into their platform. This quotation data will be accessible to the entire Aladdin client community. On the surface, this may look like yet another corporate bond data product, but first glances can be deceiving. BondCliQ's corporate bond pricing could be the next transformative technology innovation for the market.
Here is why:

Centralized Pricing Data

BondCliQ is the only producer of [centralized corporate bond pricing] which is structured differently from traditional sources like evaluated pricing products and direct pricing feeds:

Evaluated pricing products combine multiple data sources and a proprietary algorithm to generate a mid-point or two-sided market. The resulting pricing data is not an objective fact, but the evaluated pricing vendor's opinion of that bond's value. Opinions can be challenged and changed, but facts cannot.

In contrast, BondCliQ's centralized pricing is the cumulative bids and offers of market makers organized into a stack based on by best price / spread and earliest market:

Dealer	Time	Size	Bid Spread	Offer Spread	Size	Time	Dealer
OPCO	10:51		168	166	10,000	11:16	BofA
HSBC	11:07	5,000	168	166		09:29	JPM
SANT	*07:28*		*169*	165		11:20	Jefferies
MUFG	11:27	5,000	169	165	5,000	09:04	Scotia
Jefferies	11:20		170	165	2,000	10:30	JaneSt
Truist	11:31	3,000	170	165		10:52	Stifel
Scotia	09:04	5,000	170	165	3,000	11:31	Truist
BofA	11:16		170	164	600	10:00	SANT
JaneSt	10:30	2,000	170	164		11:27	MUFG
Stifel	10:52		170	164		10:51	OPCO
JPM	09:29		171	163	5,000	11:07	HSBC

This structure allows **a bond's market value to be determined by the collective prices of the dealers.** In addition, the ability to see depth of market in an individual bond improves the ability to validate available pricing data and measure available market liquidity.

Using actual bids and offers to determine the market value of a financial security may be new to corporate bond markets, but [it is the norm in modernized markets].

Direct pricing feeds are bi-lateral, private, dealer price contributions that are intended for an individual client. Dealers regularly tier the pricing they send to clients based on their perceived value, so there is unequal access to pricing information for the buy-side. Bond values derived from direct dealer feeds are subjective because they will be different for different clients.

BondCliQ's centralized pricing data does not allow client tiering, so the prices contributed by participating corporate bond dealers are distributed to all clients equally. Uniform access to market quotations produces an objective benchmark for corporate bond pricing.

How can the adoption of centralized pricing transform the US corporate bond market?

The existence of an objective, reliable, market-driven benchmark pricing source for corporate bonds improves every aspect of market structure from back office to electronic trading. Here are the specific areas that could see a material, positive transformation:

Back Office - Risk Management and Bond Valuations

The absence of centralized pricing for corporate bonds prevents reliable risk management and accurate valuations of bond portfolios. These are known issues that cause material problems for buy-side and sell-side institutions. To address this, corporate bond market makers rely on the mandatory two-week vacation to reduce the manipulation of a trader's book by the trader. This is by no means full proof: *JPMorgan's Credit-Trading Loss Hinged on Internal Valuations (Bloomberg Law - December 2022)*

For buy-side institutions, the losses incurred from inaccurate portfolio valuations are much harder to calculate, but that didn't prevent a team of researchers from producing this analysis in July of 2023: *Monetary Policy and Fragility in Corporate Bond Funds (Kuong, O'Donovan, Zhang)*

> *"we show that stale NAVs adjust downwards slowly as a response to the anticipated increases in FFTar, reaching full adjustment approximately one week after the meetings. This indicates that the fund shares are temporarily overpriced, particularly within a 10-day window around FOMC meetings."*

This phenomenon of fund mispricing doesn't just occur due to FOMC activity, it happens any time there is material volatility in the corporate bond market.

Adopting centralized corporate bond pricing is the only way to prevent millions in annual losses from fraud or stale NAVs. However, this will not directly transform the market. Improved risk taking from dealers will directly lead to greater available liquidity, while reliable NAVs will attract more investors to corporate bond funds, especially ETFs.

Front Office - Electronic Trading

"Increased transparency will make this market more electronic and more efficient," said Larry Tabb, head of market structure research at Bloomberg Intelligence. "We've seen that in the equities world, the FX world, in some of the asset classes that are more transparent and liquid."

What do equities and FX have in common? Centralized pricing.

There are three major issues with corporate bond electronic trading that can be solved with centralized pricing:

1) Backing Away

When dealers post "executable" prices on a click-to-trade platform, they are given the option of a "last-look" when inquiries are made against their posted market. A market maker "backs away" when they don't honor an inquiry and reject a potential trade.

Centralized pricing would help market makers maintain and verify that their posted prices on electronic platforms are in the context of the market. This would result in less backing away and more standing up to markets.

2) Calculating a Clearing Price

Session-based, or matching platforms are designed to connect counterparties with offsetting interests in the same bond. Once connected, those counterparties must agree to a price (spread) that the trade will occur. In theory, this level should represent a fair value for the bond. In practice, the buyer wants to buy on the bid side and the seller wants to sell on the offer side.

Traditional equity darkpools avoid this conflict by using a mid-point price derived from a centralized pricing source (a lit exchange) to affect execution.

3) Electronic Block Trading

While corporate bond electronic trading has continued to grow, block trades continue to be executed primarily by phone. There have been many attempts to find the magic trading protocol that will lead to an increase in electronic trade size, but a breakthrough has yet to occur.

Centralized pricing provides the reliable data that systematic market makers need to successfully increase the size of their electronic markets. This would result in larger trades being executed electronically.

Knowledge is Power

What history tells us about financial market development is clear: innovation is not driven by the availability of technology, it is driven by the availability and quality of market data. The dreams and ambitions of vendors (e-Trading), buy-side institutions (intra-day NAVs), market makers (systematic trading) and regulators (market integrity) can only be realized through the adoption of centralized pricing. BondCliQ has delivered the solution. It's your move now.

- Chris White, CEO - BondCliQ

Interested in leveraging corporate bond data?

If you and your organization are interested in accelerating the use of corporate bond data, please contact us (info@bondcliq.com) to arrange a meeting.

In the meantime, BondCliQ offers free daily market data dashboards that articulate activity in the following areas:

- Institutional trading in investment grade and high-yield markets
- Portfolio trading activity
- Deeply discounted investment grade corporate bonds

Click here for more information on our data dashboards and sign up here if you want to be added to our distribution list.

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