MTS™

MTS Markets

Real Mid Price = Real Added Value

While there are more than a few entities quoting a 'mid price' in the secondary bond market, there is only one backed by broker-neutral liquidity and that is immediately executable. Furthermore, while MTS's mid price crossing functionality (MidPrice) was originally seen as of primary benefit to less liquid issues, it is now delivering value across a much broader spectrum.

Every trader wants an edge. Whether it's a means of price improvement, the ability to move large volume without market impact, or simply a GUI that boosts their trading efficiency - they want it. In markets such as government bonds, where large trade size is the norm, even the most minuscule edge in any of these areas can add considerable value. The MTS MidPrice Order Book can deliver on all three of these points - and more besides. The concept is simple - an executable and broker-neutral mid price calculated from the MTS Order Book as Bid + ((Ask-Bid)*50%) - but the opportunity is considerable. The size and side of trades are not visible prior to order execution, but MidPrice crosses occur continuously as soon as two Fill-and-Store orders, or a Fill-and-Store order and a Fill-or-Kill order with opposite side and compatible size, enter the MidPrice Order Book. This delivers on the promises of price improvement and minimised market impact, but since MidPrice is already integrated into many bond trading GUIs, traders' workflow is also optimised.

The MTS MidPrice and its capabilities are therefore not to be confused with the generic 'mid prices' that are published perhaps once or twice a day by various sources, but which are neither tradable nor broker-neutral and therefore perhaps better characterised as 'mis' than 'mid'.

Easy implementation

While traders are always looking for an edge, they don't want one that also involves disruption to their workflow or a steep learning curve - nor for that matter does their IT department. To ensure that this is true of MidPrice, all MTS ISVs have already been required to add its functionality to their platforms without requiring traders to pull up a completely separate system. The implementation task for those banks running platforms developed in house has also been minimised. The functionality required to implement MidPrice at the gateway connectivity level is already in place with conformance testing complete. As a result, the only remaining task is a relatively high level GUI implementation.

This ease of implementation is already apparent from the numbers, with 16 of MTS's 25 largest participants already having MidPrice fully enabled on their main trading platform, including some who are running systems developed in-house. Clearly, the workflow integration has been successful and traders are comfortable with the new functionality, as more than €100 million traded on the MidPrice book in the first week after its launch in mid-February. For those banks still contemplating implementing MidPrice on their traders'workstations, this is a compelling proof of concept.

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Complementary fit

The MidPrice mechanism fits neatly alongside voice and other electronic trading. The depth of the MidPrice Order Book means that a mid price is immediately available for more than 1400 issues, representing some four fifths of the sovereign bonds listed on MTS. Therefore price discovery is broker-neutral and instantaneous, plus there is anti-gaming technology in place for the reference bid and offer prices used to calculate the MidPrice. Criteria include minimum depth levels of bid and offer, a maximum bid/offer spread and the selection of reference bid and offer prices only after they have been in the MTS Order Book for a minimum period.

Although there is no pre-trade disclosure of size or side, there is disclosure of a firm tradable MidPrice and also a list of trades that will be matched at that MidPrice. Furthermore, there is complete disclosure of price and size post-trade, so the MidPrice Order Book is not the same mechanism as a dark pool where the exact price is typically an unknown pre-trade.

Diverse applications, better workflow

The MidPrice book was originally seen as being of primary interest to those trading in peripheral markets where bid/offer spreads are typically wider and initially that indeed appeared to be the case, with significant activity in certain peripheral issues. However, fairly quickly very significant size also started executing in large liquid core issues. It emerged that while traders would have been reticent about showing their full size in the MTS Order Book, the additional discretion and certainty of the MidPrice Order Book made them feel comfortable trading in large size there. The ability to enter an order that moves with the dynamic MidPrice market but with the protection of a limit clearly also adds value in terms of productivity and workflow. As a result, it becomes possible to get more done, faster and at a better price.

This popularity is clearly reflected in the numbers: the MidPrice Order Book has recently included orders of up to €140 million and the largest trade completed there to date has been €25 million. The average trade size in the MidPrice Order Book is already running at an average of €10 million (and increasing), even at this early stage, which is significantly higher than the MTS Order Book.

Buy backs

Another valuable niche application for MidPrice that has recently emerged is its use by forward thinking debt management offices (DMOs) to conduct reverse auctions. The snag with conventional buy backs is that irrespective of medium (phone, trading platform or the DMO's own order book) as soon as the buyback session starts, the prices start to rise. As the time and the likely size are known in advance, it is hardly surprising that some shrewd traders take advantage by marking prices up.

By contrast, when a DMO uses the MidPrice Order Book instead, it can buy back at any point during the day without announcing it and by specifying a minimum size it can execute only in volume it considers sufficient. Furthermore, the MidPrice Order Book is ideally suited to handling the sort of very large transactions typical in buy backs without significant market impact.

Banks also benefit from this arrangement because if they know the sort of instruments that are likely to be bought back by DMOs, they can enter these in the MidPrice Order Book in large size if they wish to sell before maturity. They will thus have a high degree of certainty that they will be able to clear these from their books.

Maintaining a presence

As cost pressures have increased, a growing number of banks are looking for ever-more efficient ways to manage their inventory and risk exposure. If they wish to continue offering clients competitive liquidity and prices they will have to offset any resulting positions they do not wish to carry as cost-effectively as possible. If they don't have sufficient two way client flow to accomplish this via internal netting, then the costs of paying the bid/offer spread on interbank platforms in order to balance their inventory will quickly erode any profit.

The MidPrice Order Book offers these participants a viable alternative in that they can lay off risk as needed, but at half the bid/offer spread cost. In addition, MidPrice provides an accurate, broker-neutral and highly transparent indication of where the market currently is, which facilitates banks' participation in dealer to client systems where they need to provide prices for their clients. The key point is that the market is already naturally moving towards MidPrice, which is adding value for banks of all sizes in supporting profitable client relationships.

Conclusion

As bond markets have gradually resumed more normal activity patterns, traders have had the opportunity to grasp the advantages that MidPrice can give them. Perhaps the most obvious is price improvement, which apart from its general benefits is also delivering niche opportunities. DMOs are one group benefiting from these, as are banks seeking to maintain client relationships in markets where they lack the bilateral flows to benefit from natural hedging. Another important MidPrice edge is in workflow improvement, which (among other things) has facilitated strong activity in the some of the largest and most liquid issues. Couple these advantages with a shallow implementation curve and it's perhaps hardly surprising that MidPrice is enjoying its current scale of adoption.

About MTS Group

MTS markets provide the professional trading environment for the interdealer marketplace, enabling primary dealers from across the globe to access unparalleled liquidity, transparency and coverage.

The MTS Repo platform delivers an order driven market for the electronic transaction of repo agreements and buy/sellbacks. ACM is an electronic auction platform that uses the MTS Repo technology to enable cash-rich investors to enter into secured money market investments via the tri-party repo mechanism.

MTS further facilitates the dealer-to-client bond market through BondVision, a most trusted and efficient electronic bond trading market, delivering exceptional access for institutional investors direct to the market makers, while MTS Credit delivers an electronic market for a wide range of multi-currency non-government bonds.

Through our US broker dealer, we provide US institutional investors with real-time pricing and the ability to trade electronically with all the major European dealers on the BondVision US platform.

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

MTS Indices provide the first independent, transparent, real-time and tradable eurozone fixed income indices, based on tradable prices from MTS. MTS indices are tracked by (and can be traded via) around 40 ETFs in addition to numerous structured products.
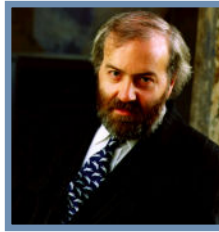
Andy Webb, Writer

Andy Webb has been writing about a broad range of topics relating to financial markets for more than twenty years. He also provides consulting services to hedge funds, prop desks and CTAs on systematic and automated alpha models including programming those models in specialist environments.

Regular writing subject areas include:

- Automated and algorithmic trading
- Back office and investment services
- Derivatives
- Financial modelling, including technical analysis and statistical arbitrage
- Financial technology
- Hedge funds, conventional funds and CTAs
- High net worth and private banking investments
- Treasury, trade finance and transaction banking

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