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Bond Market Ready for Wider Electronic Trading

Junk bonds may never trade like stocks, but there's a lot of room for improvement on the current system, in which buyers must go through intermediaries who can trade the bonds through investment banks.

So recent reports that **Tradeweb** was in talks with several banks to develop a trading platform for both investment grade and below investment grade corporate bonds has prompted a good deal of discussion about the potential for more widespread electronic trading. The general view is that it is both possible and overdue.

JPMorgan, **Goldman Sachs** and **Citigroup**, the banks said to be working with Tradeweb on the platform, are also among its owners. These banks would reportedly increase their ownership with a $100 million investment earmarked to build out the platform.

A Tradeweb spokesman declined to comment on the reports but noted, "We're always looking at different opportunities across the spectrum of fixed income and derivatives trading." Representatives of the banks either declined to comment or did not reply to requests for comment. The nascent deal was first reported by *Bloomberg* and the *Wall Street Journal*.

Whether the reports are accurate or not, many market observers believe it is only a matter of time before someone develops a go-to electronic trading platform for corporate bonds.

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Inside This Issue

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Texas Case Means a Fight for Creditors

Lenders beware: you could be fighting things out with preferred shareholders in court if a creditor declares bankruptcy. The bankruptcy case of **Park Cities Bank**'s holding companies offers a clue of what lies ahead of investors with trust-preferred securities in struggling banks—and it's not an appealing option.

North Texas Bancshares and **North Texas Bancshares of Delaware** filed for bankruptcy last month to help them sell the $425 million-asset Park Cities to a Dallas investor group.

But a judge's ruling in the case reinforces concerns that trust-preferred shareholders can end up losing big in an environment where bankruptcy is becoming an increasingly popular way to recapitalize banks.

U.S. Bankruptcy Court Judge **Kevin Gross** ruled last week that North Texas Bancshares can auction the bank's assets, with the Dallas investors placing an initial bid of roughly $7.4 million. A group of creditors had fought the auc-

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Sands a Safer Gamble for Vegas Buyers

Las Vegas Sands is spending heavily on development projects and shareholder dividends, but lenders are still comfortable enough with the strength of its balance sheet to allow for some more financial flexibility.

The casino company controlled by billionaire **Sheldon Adelson** has launched a refinancing of its existing U.S. credit facility in order to extend the maturity and remove certain financial covenants. The $3.25 billion offering consists of a five-year, $750 million revolving line of credit and a seven-year, $2.5 billion term loan.

Barclays, **Citi**, **Bank of American Merrill Lynch**, **BNP Paribas**, **Goldman Sachs** and **Scotia Bank** are the bookrunners.

Proceeds will be used to repay all

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"It's inevitable that we'll see the kinds of innovations that have come to every other aspect of our lives come to the bond market," said **Reuben Daniels**, co-founder, chief client officer and managing partner with investment bank **EA Markets**. There clearly have been successes in electronic bond trading,"

This sentiment has only become more commonplace as the appeal of junk bonds widens, attracting large amounts of money from both institutional and retail investors.

Earlier this year, money manager **BlackRock** began collaborating with securities trading services firm **MarketAxess**. BlackRock's Aladdin Trading Network, which now trades through MarketAxess, allows bond buyers to bypass investment banks in buying securities. This would reasonably prompt banks to collaborate on building trading platforms of their own. Goldman Sachs is said to have developed a sophisticated bond trading platform.

"The challenge with any electronic platform like this is that it is viewed as being independent and unbiased. Most of the efforts to try to do this that have not succeeded have been perceived as being conflicted and biased," said Daniels, who said that investment bank affiliation would not disqualify a good platform.

"It can be a stumbling block but not a stumbling block that others have not been able to overcome. … Banks have influence in this marketplace and while they may be resistant to electronic trading platforms, I think they recognize it's inevitable and they want to be in a position to capture market share in these new spaces," Daniels said.

Banks may also be pushed to embrace a widespread bond trading platform by the fact that they are no longer holding onto the same volumes of debt inventories as they were years ago. This is partly as a function of risk aversion and partly because of new capital requirements instituted in reaction to the credit crisis of five years ago. This means that banks won't have the bonds to sell to buyers like they used to, and buyers would have to turn to other investors looking to sell rather than banks.

"Market makers that are willing to take some risk to make markets for the clients…. That's what's been lacking. "

"Through all of these capital adequacy and capital requirement regulations, the banks have come to believe that they are not going to be the liquidity provider of last resort when it comes to assets that trade by appointment," said **Ron D'Vari**, CEO of advisory firm **New Oak Capital**.

And use of existing trading platforms has been increasing significantly in recent years. MarketAxess' high yield bond trading platform sees about 5% of junk bonds tracked by the Financial Industry Regulatory Authority (Finra)'s Trace (Trade Reporting And Compliance Engine). Its investment-grade bond trading platform comprises about 15% of Trace volume. MarketAxess has seen its high yield bond trading volume increase 80% over the last year, according to **Sandy White**, head of high yield products at the firm.

"One of the reasons growth is so strong is we've finally reached point of acceptance in the market," White said. "There was a long period of resistance, but through persistence and client demand we finally got over the hump and business is beginning to accelerate."

High yield trading volumes averaged $6 billion per day in the month of November, a slight decline from October's average of $6.3 billion per day. September's trading volumes averaged $6.1 billion per day, a significant increase from August's $3.9 billion daily average. As of Dec. 3, fourth quarter 2013 trading volumes are averaging $6.1 billion compared with $4.9 billion in Q3 and $6 billion in Q2 and Q1, according to Trace data compiled by JPMorgan's North American Credit Research group.

Junk bond trading volume is also on the increase this year over the last several years. Year-to-date, high yield bond trading volumes are averaging $5.7 billion per day. That's up from the average trading volume for 2012 of $5 billion, which was an increase over 2011's average of $4.2 billion. The previous two years saw consistent trading with $5 billion average in 2009 and a $5.1 billion average in 2010.

Market participants note that high yield bonds generally are not as easy to trade online as equities or even investment grade corporate bonds. There are multiple classes of junk bonds put out by a single issuer, many with different coupons and covenants. Equities usually consist of one or maybe two or three classes of securities in the cases of preferred shares.

"The more esoteric a security becomes, the more human intervention is required in trading," said White. "By the nature of the product, high yield bonds will probably never be as actively traded electronically like more liquid markets such as high grade and other markets. It's just the nature of the beast. That being said we think there's significant growth potential."

But the real test of success will be getting "market movers" to bring large, sizable deals to these platforms and provide them with the liquidity to move large volumes. It's not that the technology is not up to spec, generally speaking, market observers say, but until large buyers and sellers decided on a platform to migrate too, all the efforts may be for naught.

"MarketAxess and Bloomberg have had some success, but there are some real issues when it comes to real institutional-size trades. That's where the gap is," said **Kevin McPartland**, head of market structure research with **Greenwich Associates**. "Market makers that are willing to take some risk to make markets for the clients who want to buy or sell the bonds: That's what's been lacking." *—MS*