

MTS Mid Price:

Speed, Security, Simplicity

One of the biggest challenges for market makers in sovereign debt is covering risk quickly, efficiently and without having information leakage. Guido Galassi, Product Manager of Cash Markets, MTS Markets, explains how the new automated version of MTS Mid Price delivers on all these points.

Challenging times, limited solutions

For many banks, various factors have radically changed the way in which they conduct their market making activities in European sovereign debt. This has left them with conflicting objectives:

- ▶ They are required to make prices to support the secondary market liquidity provision needs of debt management offices (DMOs)...
- ▶ ...but they do not wish to consume balance sheet unnecessarily, nor be hit or lifted on somebody else's terms.

Conventional means of covering positions resulting from market making activity are inefficient:

- ▶ Using cash bonds: both trading on the regular order book and using more traditional trading methods risk information leakage and negative slippage. (The alternative of laying off to clients is not a practical option unless the bank does very large volumes of client business.)
- ▶ Futures: potentially imprecise hedge for actual exposure.

This problem applies across the board, but at present particularly affects two groups:

- ▶ Banks that have limited balance sheet capacity available for sovereign debt market making and so must have fast inventory turnover.
- ▶ Traders covering inflation and other markets where bid/offer spreads are wide.

A practical alternative...

The latest version of MTS Mid Price gives traders a practical alternative by providing a highly automated market with firm pricing, with the key distinction that participants' activity and intent are hidden. Mid Price is a completely separate order book where traders can send executable orders to buy or sell at their own mid level.

On Mid Price, hidden matching occurs at the Mid Level of the MTS standard order book only when a robust (i.e. tight spread, sufficient depth) Mid Price can be calculated, the book is 'open for trading', and an opposite order exists from another counterparty.

Only the MTS Mid Price is visible in the Mid Price order book and this price is highlighted (*see orange highlight in Figure 1*) whenever there is an order to buy or sell at this level. No individual order details are visible in the order book, so it is impossible for other participants to see the size or side of any orders placed.

MTS Mid Price is already supported by the latest software versions of leading MTS ISVs. Configuring mid price streaming is therefore simple to set up and price updates are completely automated.

...with multiple benefits

DMO obligations: trading activity on MTS Mid Price may qualify for satisfying DMO requirements and/or may contribute to DMO rankings.

Discretion: a critical difference between MTS Mid Price and the regular order book is that on Mid Price a trader's pre-trade activity is completely invisible to other participants, so there is no risk of information leakage. All that is visible is the MTS Mid Price for each issue, which becomes highlighted whenever there is an order to buy or sell (see orange highlight in Figure 1) at that mid price.

Control: Any trades executed on the MTS Mid Price order book will be on the trader's terms, as opposed to an aggressor's.

Flexibility: while a trader's own mid price for a bond may differ from the MTS Mid Price, this is not a problem. The trader's desired mid price can still be posted anonymously in the Mid Price book and will immediately become tradable (highlighted as in Figure 1) should the MTS Mid Price hit the same level.

MTS Mid Price - Figure 1

MTS Mid Price

| 38 | Ticker | Cpn | Maturity | PX | Strategy | Bench. | Prc | Yld | MTS Mid Price | Status | Price MP | Price Spread MP | Yield Spread MP | VQty | Side |
|----|--------|-------|-----------|----|--------------|--------|---------|-------|------------------|--------|----------|-----------------|-----------------|------|------|
| 2 | DBR | 4.250 | 04-Jul-18 | ● | TED-Spread | 71.66 | 102.330 | 0.402 | | on | 102.337 | 0.6 | 1.0 | 10 | Sell |
| 3 | DBR | 3.750 | 04-Jan-19 | ● | TED-Spread | 80.20 | 103.580 | 0.513 | | on | 103.592 | 1.1 | 1.0 | 10 | Sell |
| 4 | DBR | 3.500 | 04-Jul-19 | ● | Curve Spread | 85.78 | 104.588 | 0.622 | 104.5825 | on | 104.570 | 1.7 | 1.0 | 10 | Buy |
| 5 | DBR | 3.250 | 04-Jan-20 | ● | Curve Spread | -3.6 | 105.336 | 0.696 | | on | 105.315 | 2.2 | 1.0 | 10 | Buy |
| 6 | DBR | 3.000 | 04-Jul-20 | ● | Curve Spread | -13.9 | 105.890 | 0.712 | | on | 105.895 | 0.5 | 0.2 | 10 | Sell |
| 7 | DBR | 2.250 | 04-Sep-20 | ● | Curve Spread | -15.8 | 104.155 | 0.733 | | on | 104.185 | 2.8 | 1.0 | 10 | Sell |
| 8 | DBR | 2.500 | 04-Jan-21 | ● | Curve Spread | -12.9 | 105.069 | 0.843 | 105.0650 | on | 105.065 | 0.3 | 0.1 | 10 | Buy |
| 9 | DBR | 3.250 | 04-Jul-21 | ● | Curve Spread | -17.0 | 108.230 | 0.920 | | on | 108.27 | 3.7 | 1.0 | 10 | Sell |

● When the standard order book is liquid a Mid Price is published by MTS

● The Mid Price is highlighted when there is an order to buy or sell at mid and can be aggressed to attempt matching

● You can manage the Mid Price as per standard quoting features including:

- Status (On/Off)
- Level Contributed
- Spread from your Mid (cts/bps)
- Quantity
- Side (Buy/Sell)

...with multiple benefits

Automation: if a suitable order management system (OMS) or execution algorithm is being used, trading/hedging on MTS Mid Price can be completely automated. Hedges for any trades executed on the regular book can be set up to post automatically to the MTS Mid Price book and be managed automatically once there.

Contingent orders: if the OMS/algorithm supports time-contingent orders, then the price can initially be posted several basis points from the current MTS Mid Price. Then if it fails to execute after a pre-determined period, the OMS/algorithm can adjust the price progressively closer to the displayed MTS Mid Price until it is finally filled. Similar capabilities apply to spread trades where other legs can be executed immediately (if desired) after the first leg fills.

More accurate hedging: there is good chance of obtaining a perfect hedging match on MTS Mid Price, without any of the information leakage risk and additional spread cost of using the regular book. Even if that isn't possible, a far more accurate hedge than just using futures should still be achievable.

Positive slippage: by posting blind on the MTS Mid Price book close to the current MTS Mid Price (on the appropriate side), traders have the opportunity of picking up positive slippage on their trades.

Immediacy: for urgent trades, traders can simply post in the MTS Mid Price book at the current displayed MTS Mid Price for immediate execution. This is a far better option than the alternative of aggressing on the regular book, which results in information leakage plus having to incur the cost of crossing the spread.

Conclusion

The latest version of MTS Mid Price is another example of MTS's 30 year commitment to technological innovation. It enables traders making markets in European sovereign debt to perform as efficiently as possible in the current highly demanding environment. Its fully automated capabilities make it possible for dealers to cover all their bases by managing very large trade volumes, with minimal effort, and without moving the market.

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YEARS OF
INNOVATION

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