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16 Apr 2013 13:45 EDT **DJ Electronic Bond Trading Is Coming Of Age**

By ***Katy Burne***

The nascent interest in up-and-coming electronic venues is a sign the $9 trillion U.S. corporate bond market is beginning to mature. Despite their recent traction, the new platforms are seen as only part of the solution the industry needs as it evolves, according to a new report from independent research firm TABB Group.

Networks that either cross trades between customers as opportunities arise, or match trades on a single-dealer owned platform are limited, partly because they aren't designed to address facets of the whole market, according to the researchers.

"Electronic trading is taking hold in the corporate bond markets," notably in small trade sizes under $1 million, wrote TABB analysts Henry Chien and Will Rhode. But they added: "Liquidity must be aggregated for multiple networks to consolidate as a marketplace."

The release of the report Tuesday coincides with a meeting at the Securities and Exchange Commission about potential improvements in corporate bond market structure.

Robert Smith, president of Sage Advisory Services, an $11 billion money manager who is attending the SEC roundtable, said the rise of new platforms is evidence that investors have been looking for ways to speed up bond trading, although he said the new venues are "never going to carry the day" if traders rush for the exits all at once.

By and large, banks have moved to protect their own franchises by spending spending tens of millions of dollars on proprietary bond trading systems. The recent experiments on other electronic venues are proof that dealers and investors alike are growing impatient with the status quo, however.

"It's pretty obvious from the noise being generated that there is frustration with the market function," said Dominic Holland, head of credit e-sales at Deutsche Bank AG (DB, DBK.XE). The bank has been working with customers and other dealers on a new platform, which Mr. Holland says wouldn't cannibalize existing ones from banks.

Bond traders' current frustration stems from the fragmented nature of orders and the changing role of dealers in the wake of the financial crisis. Post crisis, investors are holding more inventory than dealers, giving them a reason to support new systems that can link up market participants.

For now, the vast majority of corporate bonds still trade over the phone. The reliance on banks as middlemen is unlikely to go away soon. "Locating bonds is an art not a science," said Erik Falk, co-head of leveraged credit at private equity firm KKR & Co. (KKR).

But with banks looking to dial down risk, investors and dealers have started to embrace electronic venues as a way to find new trading partners, especially on small trades.

Also driving the testing of new platforms: a desire to protect against any tumult that could accompany an attempt by the Federal Reserve to exit its monetary easing programs.

So far, their newfound success has been particularly pronounced when big corporate news, such as a merger or buyout, causes rapid shifts in investors' appetite for particular securities.

Bonds.com is one recent beneficiary; it matches trades anonymously like a stock exchange does. On average, Bonds.com captures just 2% of trading in the daily volume in corporate bonds. But the platform saw 23% of the trading in AT&T Inc. (T) bonds Feb. 18, and 10% of the trading in Verizon Communication Inc.'s (VZ) bonds on March 5, when investors learned of a possible merger between it and Vodafone Group PLC (VOD).

"We're not supposed to be that volume of the market," said Thomas Thees, CEO of Bonds.com Group Inc. (BDCG) and former head investment grade credit at Jefferies. UBS AG (UBS, UBSN.VX) has an equity stake in the platform.

MarketAxess Holdings Inc. (MKTX), which has the largest share of electronic corporate bond trading in the U.S. at 13%, has seen increasing adoption of a service that allows traders to send orders to all participants in the platform, whether dealers or customers. That could be seen as a step in the continuum towards an exchange, said Rick McVey, CEO of MarketAxess.

On BondDesk Group, institutions are "moving to retail platforms they never would have considered before," said Joseph Colleran, head of institutional trading at BondDesk, who previously ran retail trading at Morgan Stanley. "They go to their dealer and they're not able to get it done, so they come in here with the attitude that 'it can't hurt to try.'"

To critics, investors' relationships with their banks will remain a dominant force because of historical relationships. A bond exchange from NYSE Euronext (NYX) has seen low volumes since it was launched in 2007.

Supporters of electronic trading, however, argue that such venues offer advantages, such as allowing traders to handle residual positions so they can spend time on larger orders over the phone.

**"We also go to the phones, but more and more frequently we go to one of the electronic platforms," said Jason Graybill, Senior Managing Director at Carret Asset Management LLC.**

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