

BondCliQ

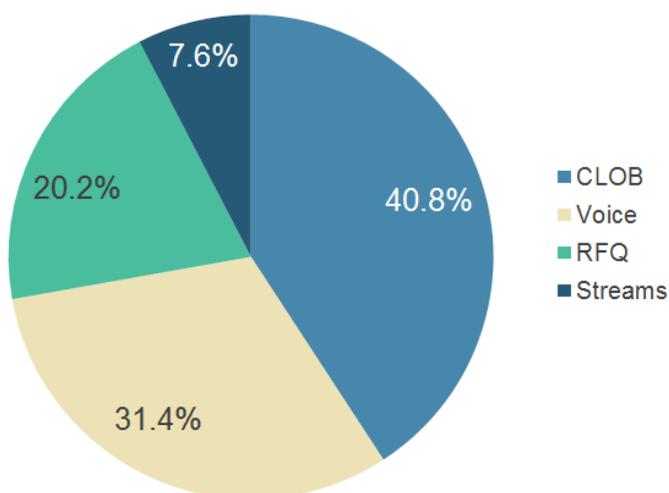
The Inside Market January 2021

The eventful first two weeks of 2021 have not been exclusive to US politics. Capital markets fintech for fixed income has seen [Fitch acquire CreditSights](#), the promise of a new [OMS built by Microsoft](#), and the [approval of the LSE takeover of Refinitiv](#) all happen since we moved into the new year. While those announcements were important, the most interesting news in fixed income fintech so far this year is the closing of trading platform OpenDoor and the latest funding round at a valuation of \$1.4bln for trading platform Trumid. From 30,000 feet, both platforms look almost identical. Each were launched about seven years ago with the goal of expanding electronic bond trading through a periodic (matching) protocol. Fast forward to today, we have to ask ourselves, **what created the gap that has one initiative closing its doors, while the other is valued higher than any other privately held fixed income trading platform in history?**

Disclaimer: When a platform ceases operations, it is best to hear the story of what happened straight from the people who were a part of building it. For example, last year I wrote about what happened to the GSessions trading platform ([Why G-Sessions Failed](#)). The views expressed in the rest of this article are my observations alone.

Electronic Trading in Bonds

U.S. Treasury Trading by Protocol – May 2019



Source: Greenwich MarketView

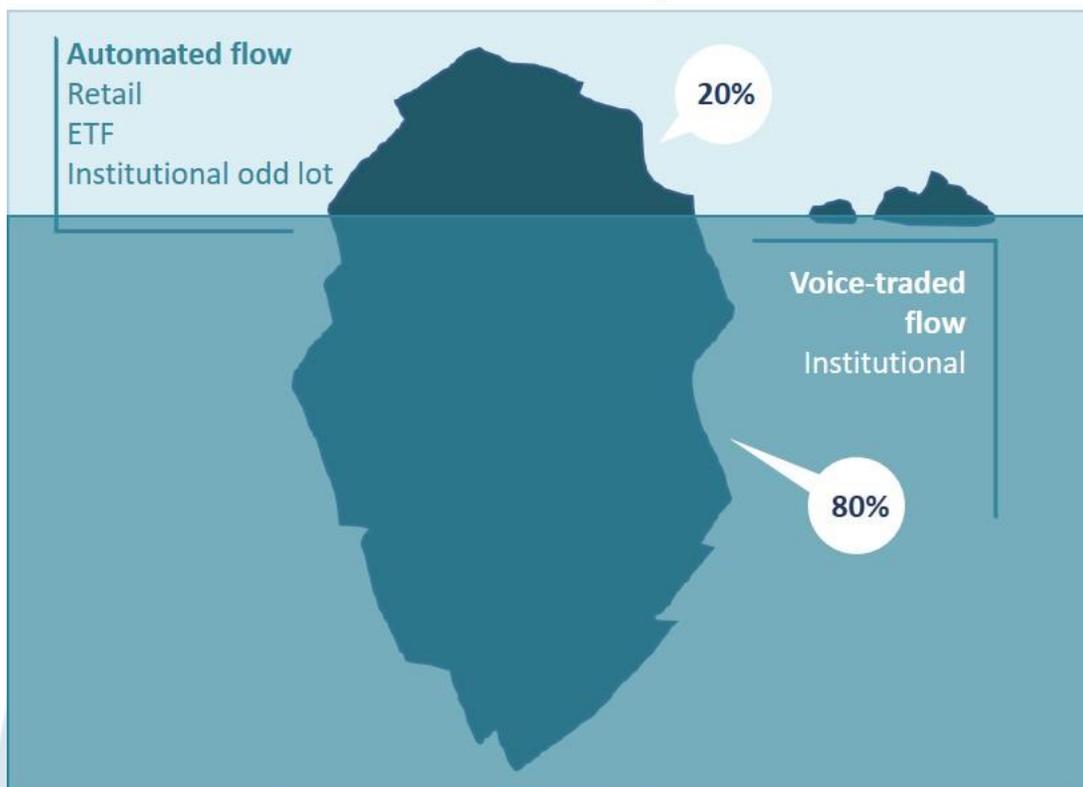
Pundits, analysts, and research providers have been talking about the electronification of bond markets for years now. The general view is that everything fixed income will eventually become electronic, so each year they talk about how an inflection point has been hit and we are on the cusp. There is a nuance to the bond eTrading conversation that is directly related to answering the question on why Trumid and OpenDoor have divergent fates. OpenDoor was focused on bringing electronic trading to off-the-run treasury bonds, which, relative to on-the-run treasuries, do not trade electronically. However, relative to other fixed income asset classes (loans,

corporate bonds, CDS), the entire US treasury market is light years ahead in electronic trading. The treasury market has multiple, well-established electronic protocols, so from a perception standpoint, new ideas around electronic treasury trading garner less excitement.

The Trumid platform is focused on US corporate bonds. Despite the progress made by providers like MarketAxess, Tradeweb, and Bloomberg, electronic corporate bond trading still feels like a frontier ripe with opportunities. Many believe that the gold in them there hills resides in bringing block trading into the electronic market.

The Majority of the Corporate Bond Market Is Still Traded by Voice

Source: Aite Group



So, right off the bat, a major difference between OpenDoor and Trumid is the market's perception of their potential opportunity. Success for OpenDoor would mean being a part of a well-established ecosystem with razor thin margins, while success for Trumid could mean the transformation and domination of a lucrative and large part of the credit market (by volume).

I Wanna Be Like Mike

One of the most successful marketing campaigns of the 1990's was the [Be Like Mike commercials from Gatorade](#). The ad was simple, drink this and you can be like Michael Jordan. Since Mike was so successful, even the casual fan or non-sports fan could relate to the message. Also, be like Dikembe Mutombo Mpolondo Mukamba Jean-Jacques Wamutombo doesn't quite roll off the tongue in the same way. Well, any new idea needs a 'Mike' because it helps potential investors envision what is possible. MarketAxess has been the Michael Jordan of electronic corporate bond trading due to its success and the performance of its stock over the past 10 years.



523.00 USD +10.92 (2.13%) ↑

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After hours 523.00 0.00 (0.00%)



The same is not the case for electronic US treasury trading because most platform providers have businesses that are broad and diverse. Therefore, it is difficult to ascertain just how valuable a stand-alone electronic US treasury platform could be. Without this example, it is more difficult for OpenDoor to make a case for continued investor support. Meanwhile, each new record hit by MarketAxess stock serves as the perfect FOMO commercial for Trumid.

Strategy

Changing and adapting an idea from its original concept is a key part of developing a successful solution. **There is a fine line between having the dogged determination to get a new idea established and not recognizing when you have a material flaw in your product that prevents success.** Both Trumid and OpenDoor began as initiatives focused on increasing trading activity in less frequently traded bonds by introducing new electronic trading protocols. Popular opinion is that this type of alchemy is possible, despite a lack of supporting evidence. Undoubtedly, electronic trading helps improve the efficiency of execution in areas of a market that are actively traded. However, beyond that, it remains to be seen if electronic trading can be the catalyst for changing the dynamics of illiquid parts of a market. This is why the [recent announcement from FINRA](#) that they intend to add indicators to identify which treasury trades are the result of (ATS) electronic trading is so meaningful. If it passes, we will finally have quantifiable statistics on where electronic trading is making an impact.

Why does this matter? At some point, Trumid pivoted to focus on electronic trading for new issue bonds on the break, which is a time when a bond is most liquid:

*“We observe that **bonds are at their peak latent liquidity levels when they are just issued**. Their latent liquidity level decreases steadily after issuance, until final maturity.”*

[Latent Liquidity: A New Measure of Liquidity, with an Application to Corporate Bonds](#)

This shift has been a successful beachhead that gave Trumid the ability to grow their user base and continue experimenting with new protocols.

Last May OpenDoor attempted a similar strategy by [expanding trading to on-the-run treasuries](#), but this shift did not result in securing a strong foothold because electronic trading in that part of the market is extremely competitive.

Collaborating with Dealers

The foundation of Trumid's early platform was the idea that banks were not able to be adequate liquidity providers anymore, so their platform would be needed:

"The biggest structural impediment is that [Wall Street banks are no longer able to commit capital to take the other side of buy-side trades](#) the way they did before the 2008-2009 global financial crisis and the ensuing waves of regulation. The situation is especially acute given the recently robust new-issue calendar.

"You have more product coming out, and less ability to take risk," Ruggiero said. "99% of inventory is held in the hands of buy-side accounts, and dealers are 1%. So you're trying to squeeze this enormous inventory of bonds through this bottleneck, skinny channel of dealer inventory. Why not open up the canal so that firms can trade with each other."

[Trumid to 'Swarm' Corporate Bond Market – Markets Media](#) 2015

Four years later, Trumid concluded that they were better off constructing a platform that works with corporate bond dealers instead of against them:

"Trumid users now have the option to negotiate bilaterally or to trade anonymously. When utilizing the new [Attributing Trading protocol](#), traders may connect directly with each other to negotiate and trade. [This relationship-based protocol allows sell-side traders to advertise axes](#) via FIX or enter orders directly in the Trumid Market Center."

[Trumid Rolls Out Attributed Trading – Markets Media](#) 2019

This is a 180 degree change from Trumid's initial idea and made it possible for the platform to secure strategic relationships with top corporate bond dealers. It is no coincidence that the week before Trumid announced their latest funding round at a \$1.4bln valuation that Goldman committed to support the platform.

OpenDoor had also positioned itself as a solution to lack of performance from liquidity providers:

"OFTRs comprise more than 98% of notional outstanding but less than 32% of daily trading volume in the \$17-plus trillion U.S. Treasury market, according to U.S. Treasury and FINRA data. The enhanced [OpenDoor platform addresses this liquidity imbalance – in part caused by shrinking dealer balance sheets](#) and concentration of trading among fewer market makers"

[OpenDoor Brings Continuous Order Book for Illiquid Treasuries](#) – Traders Magazine 2020

However, instead of shifting to a protocol that would strengthen dealer to client relationships, OpenDoor's order book for illiquid treasuries was an anonymous, all-to-all model. This structure is very difficult to get established in any institutional market because both buy and sell-side firms fear a loss of relationships and their benefits when trading in an anonymous environment. This fear is

exacerbated in illiquid parts of the market because organic, client to client liquidity is difficult to consistently harness (we wrote about this in our February 2019 blog post: [Bigfoot and Buy-side Liquidity](#)). Therefore, it is no surprise that OpenDoor did not garner public support from major market makers. This ultimately hurts broader adoption of any new solution because **buy-side clients, especially larger ones, often require participation from tier-1 dealers to commit to a platform.**

Fixed Income Innovation

Fixed income markets have rapidly become the most important products in finance, and their power and influence over global markets is only growing. Given this position, it is vital that innovation in fixed income markets be cultivated and encouraged. **Each new attempt is an invaluable learning opportunity, so all builders of new solutions deserve our respect and admiration, regardless of the result.** In addition, those that develop new ideas in data, trading, and analytics have a responsibility to heed the lessons of their predecessors to avoid repeating mistakes. OpenDoor and Trumid are the latest example of why positioning an idea as a replacement for sell-side services is not a path to success. Both initiatives eventually changed course to become more collaborative and inclusive of sell-side participation. At BondCliQ we have modeled our approach to developing high-quality market data with this core guideline in mind. **Building a better fixed income market requires solutions that will help sell-side institutions perform their duties, not threaten their existence.**

