



**afme** / Association For Financial Markets in Europe

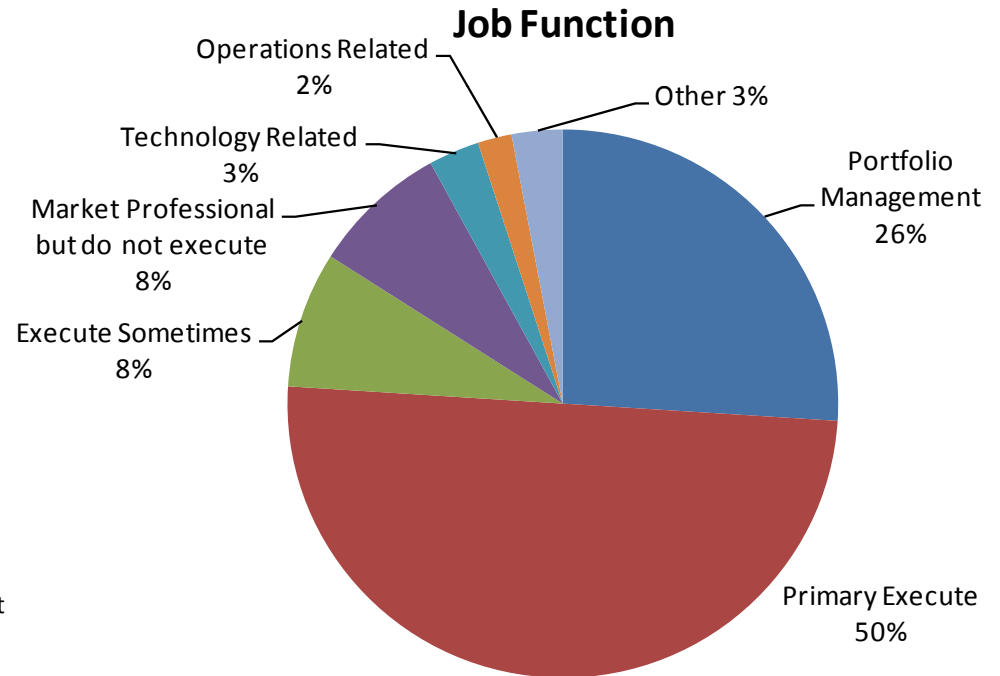
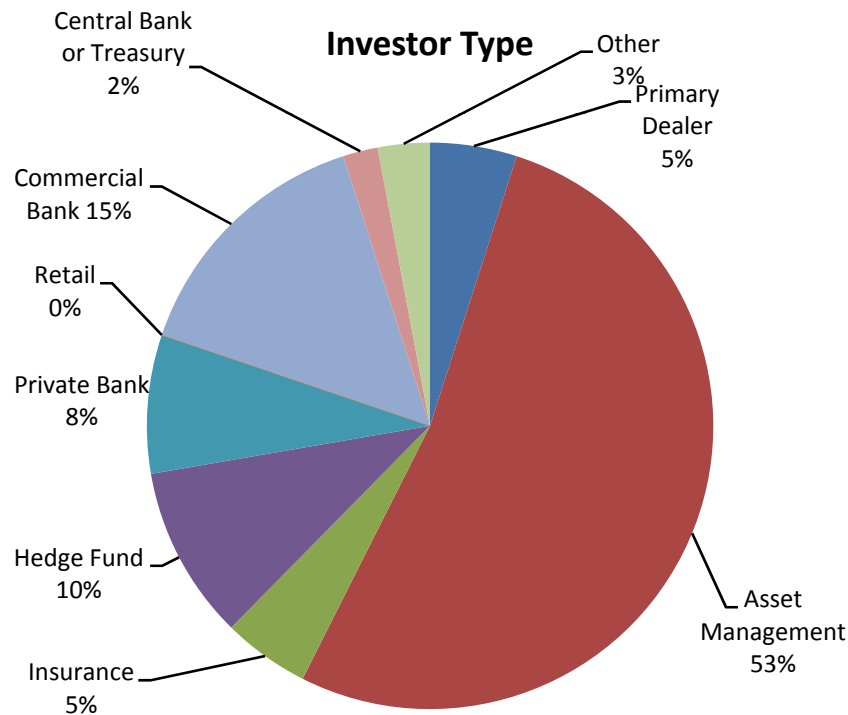
**6<sup>th</sup> Annual Market Liquidity Fixed Income Survey**  
3<sup>rd</sup> February 2011

Mark Austen, *COO, The AFME*

# afme / Buy-Side Demographics

## Function and Investor Type

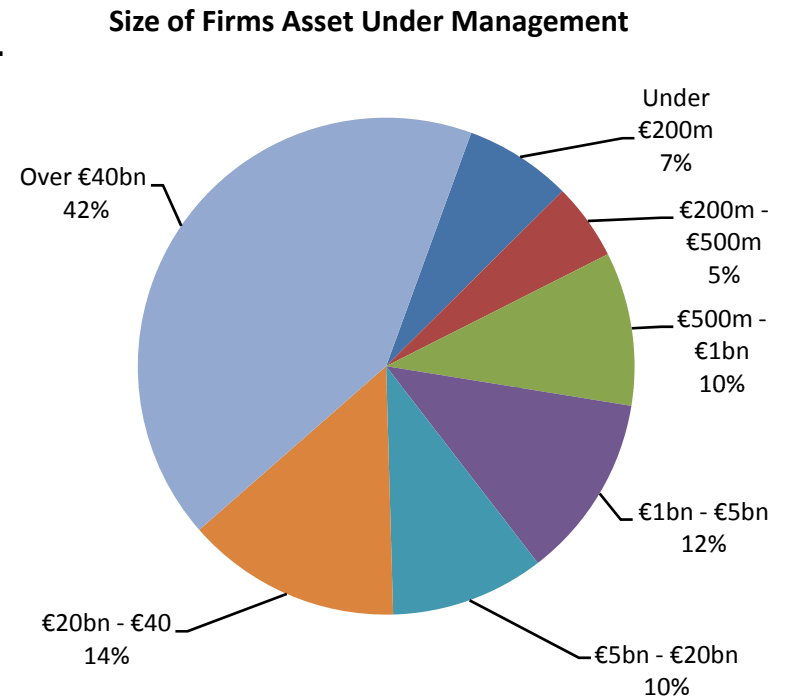
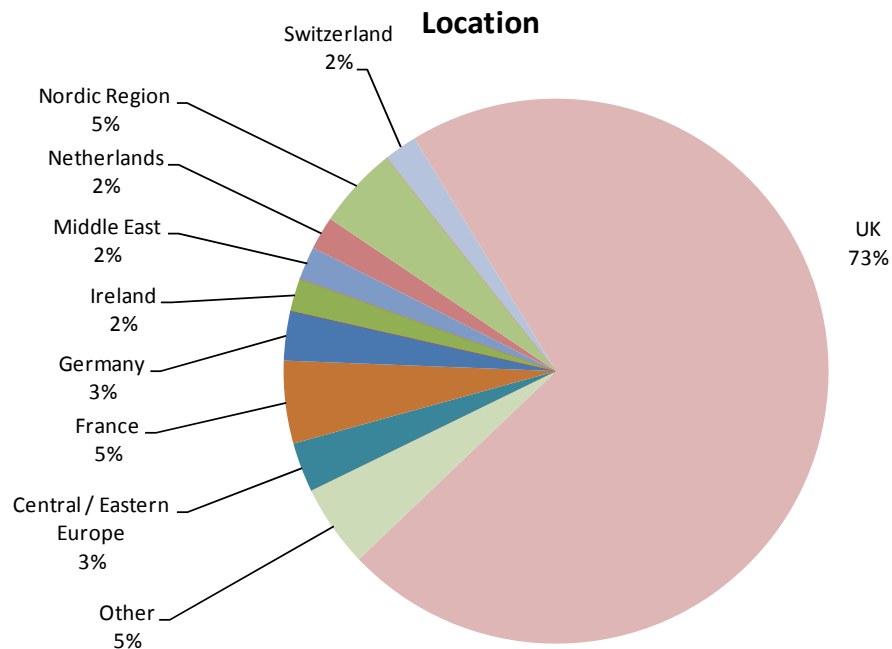
- 61 buy-side respondents
- 50% of respondents primarily in an execution function
- 53% of investors were from Asset Managers



# afme / Buy-Side Demographics

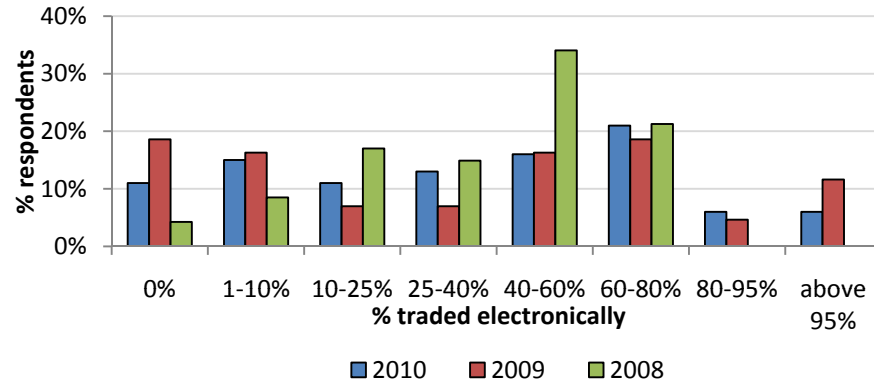
## Size and Location

- 42% of buy-side from firms with over 40bn AUM.
- 73% of firms based in UK, 5% in Nordic Region and 5% in France.
- Other major locations include Germany and Central Europe Region.

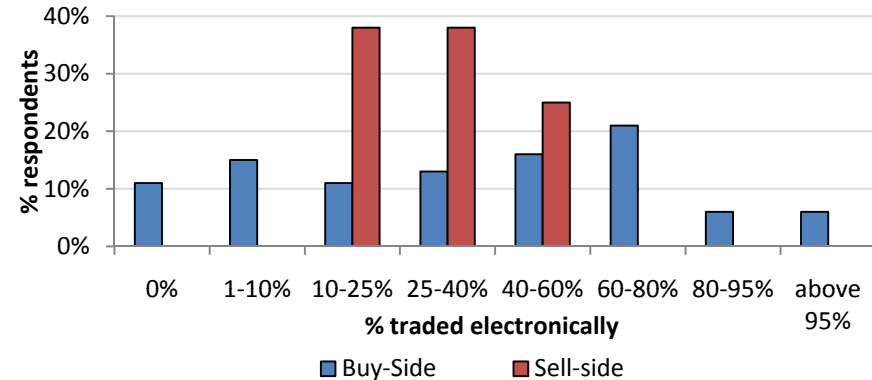


# afme / European Fixed Income Electronic Trading

Percentage of Overall Trading Electronically in Europe



Buy-Side and Sell-Side Electronic Trading in 2010



Electronic trading continues to be a significant trading method for the buy-side, but only measured growth seen over the course of 2010:

- 33% of buy-side respondents executed more than 60% of their trading electronically, versus 35% in 2009 and 21% in 2008.
- Some signs of increased growth observed. In 2009, 35% conducted only 10% of their trading electronically. This was lower in 2010 with 26% in this range.
- For sell-side, e-trading remains a complementary service with OTC and majority of respondents conducted 25-40% electronically.

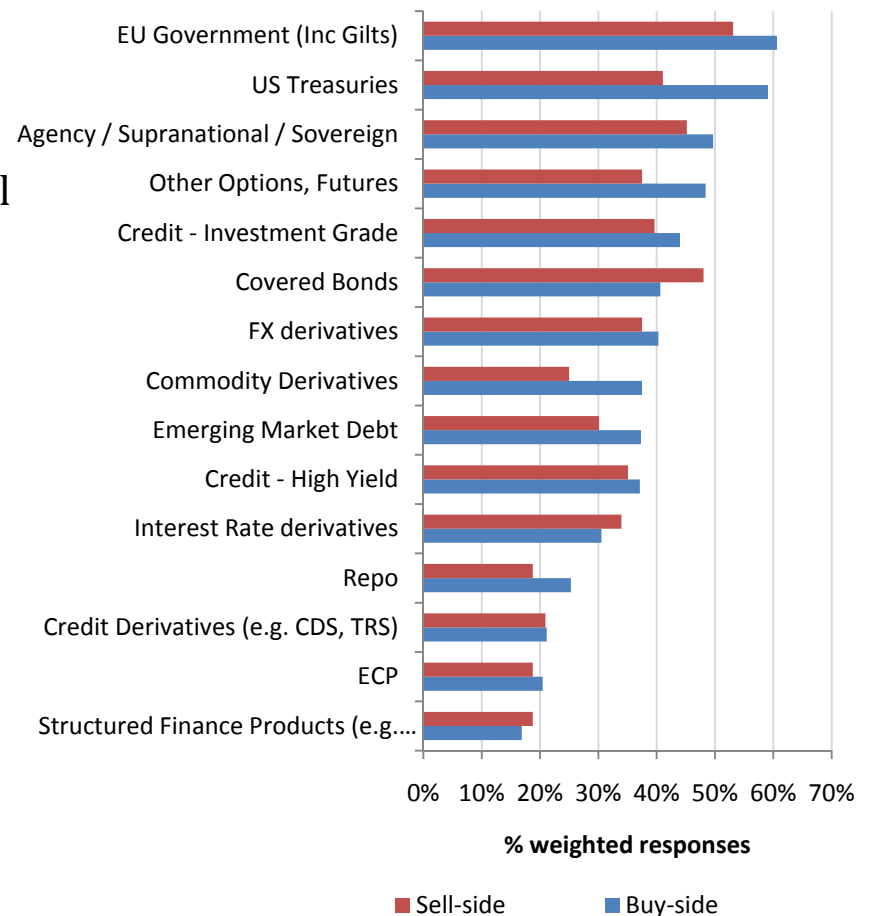
# afme / Electronic Trading Volumes in 2010 – by Product

Top 3 products traded electronically in 2010 for buy-side were EU Government Bonds, US Treasuries and SSAs (Supranational, Sovereigns and Agencies).

Credit Derivatives, ECP(European Commercial Paper) and Structured Finance Products were the products least traded electronically.

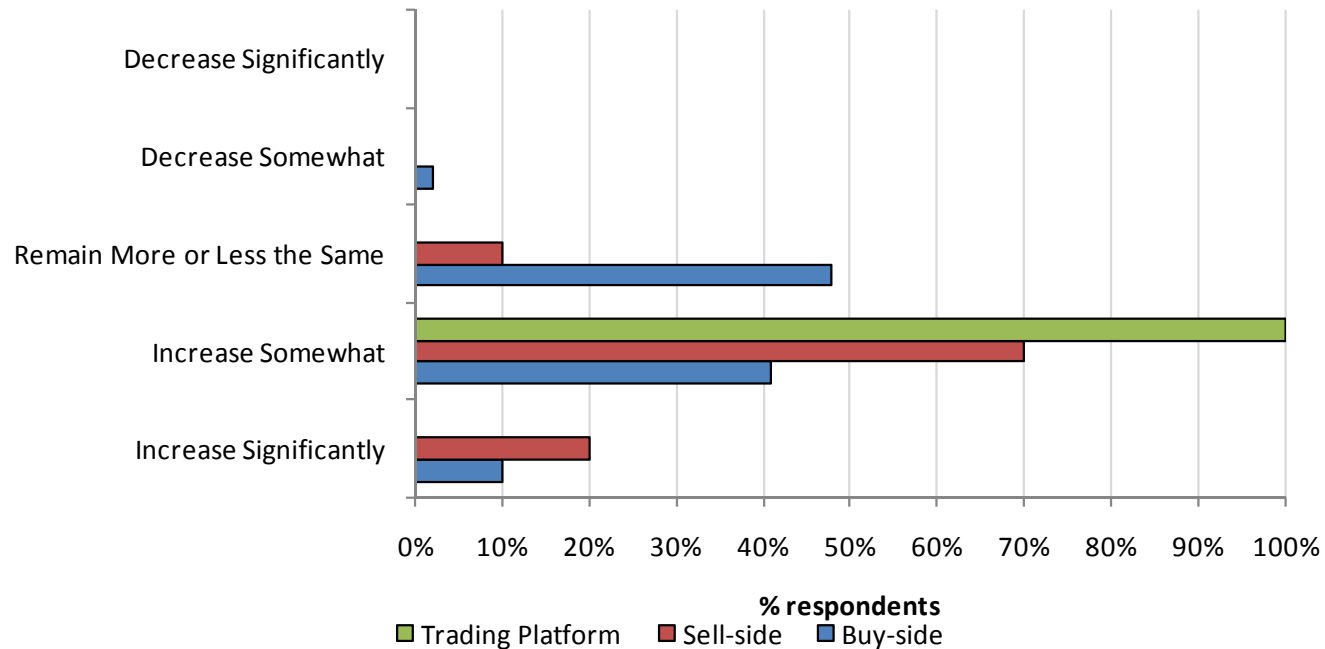
Similar story from the sell-side. However, Covered Bonds is also a notable product traded electronically.

Trading Volumes Executed Electronically in 2010 – by Product



# afme / Expected Electronic Trading Volumes in 2011

## Expected Electronic Trading Volume in Europe in 2011



Majority of respondents expect to see an increase in electronic trading volumes in 2011:

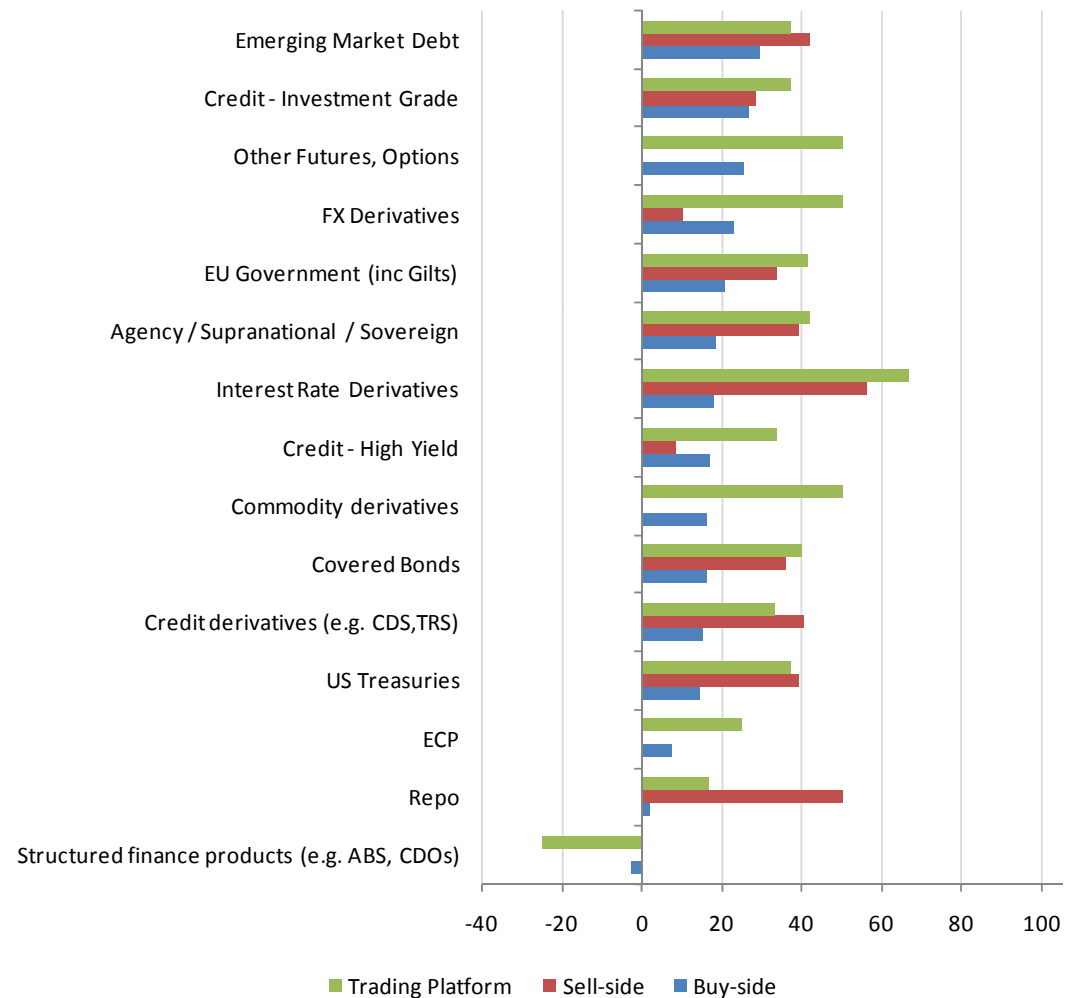
- 51% of buy side expect some increase, 48% expect volumes to remain the same and 2% expect a slight decrease.
- For the sell-side, 90% expect to see growth whilst 10% expect levels to remain the same as this year.

# afme / Expected Levels of Electronic Trading in 2011

Buy-side see Emerging Market Debt and Investment Grade Credit as two products that they expect to trade more electronically.

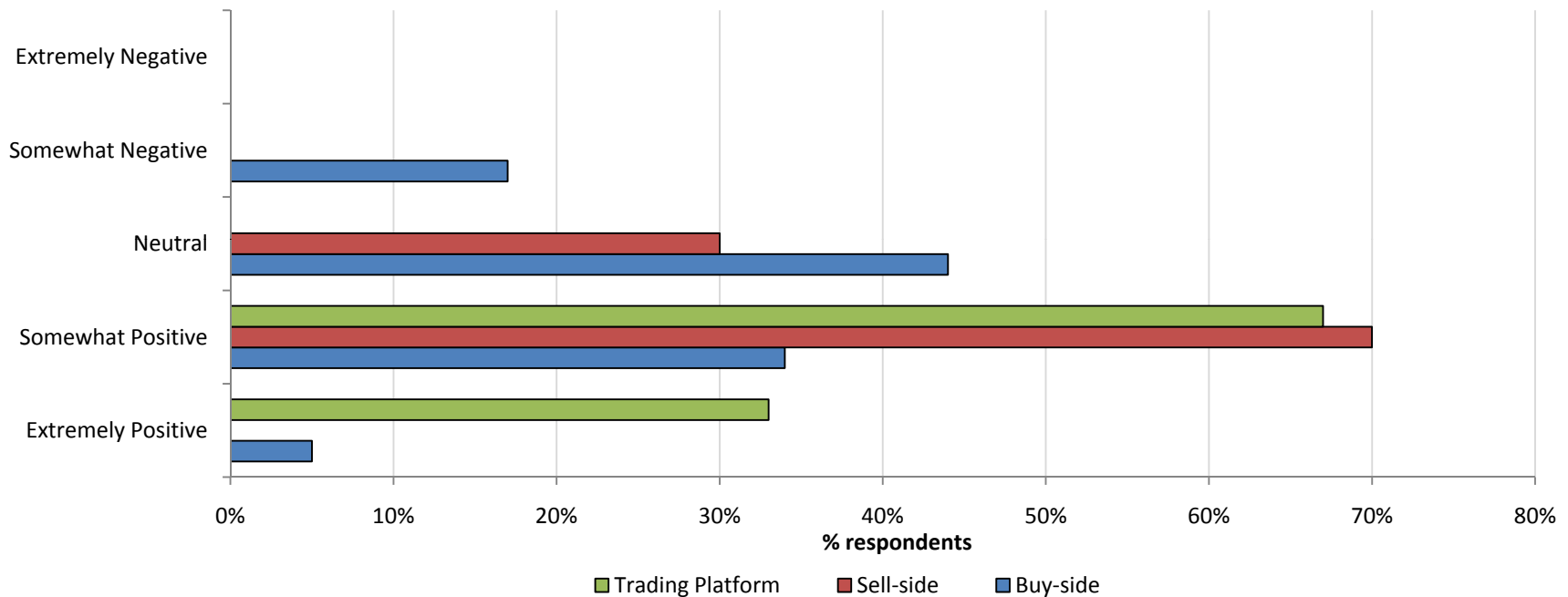
For the sell-side, top areas remain rates focused – Interest Rate Derivatives and Repos.

**Expected Electronic Trading Volumes by Product**



# afme / Impact On Client-Dealer Relationship

Impact of Electronic Trading on Buy-Side / Sell-Side Relationship



Sell-side and trading platforms saw a positive impact of electronic trading on their relationship with clients:

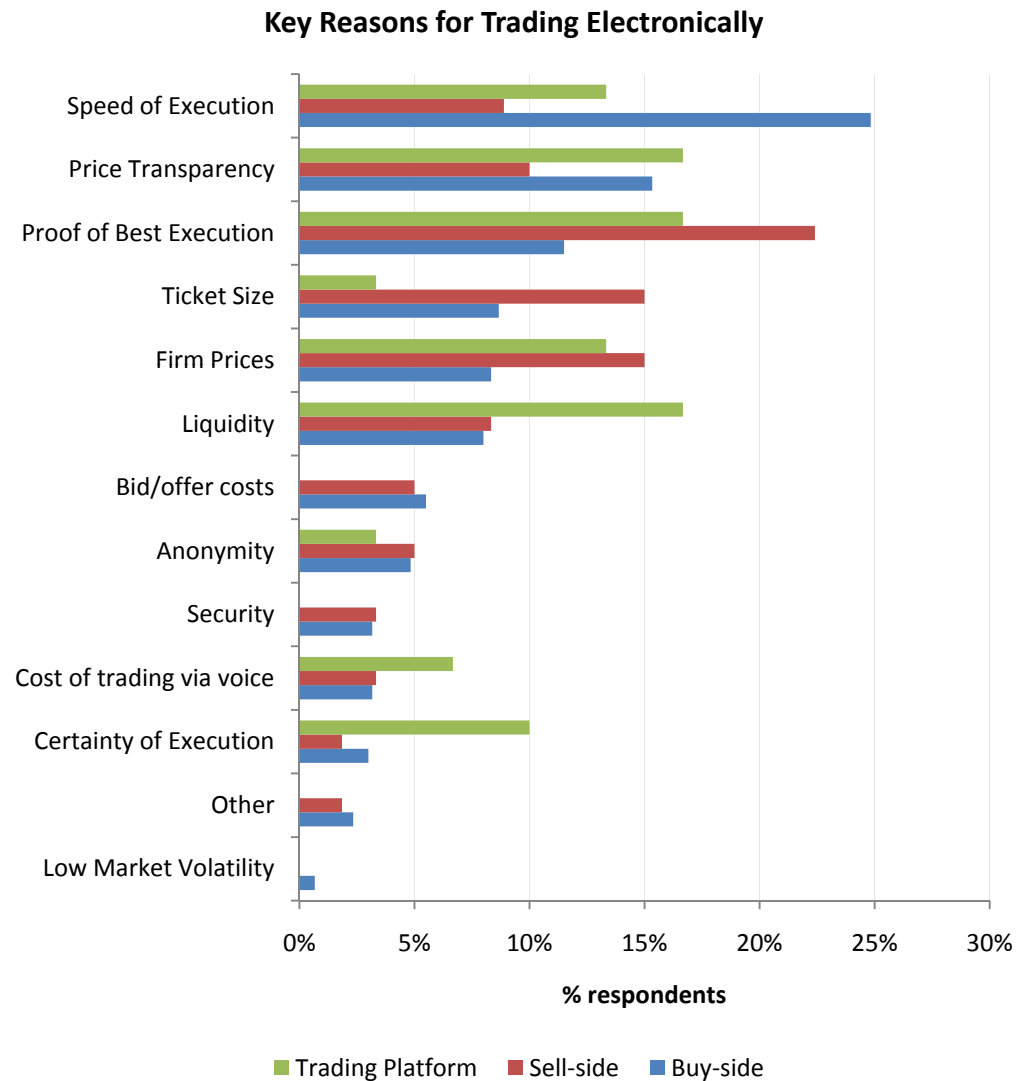
- 70% of sell-side were somewhat positive, 30% remained neutral.
- Only 39% of buy-side saw a positive impact; 44% were neutral and 17% saw a negative impact on the client-dealer relationship.



# afme / Keys Reasons For Trading Electronically

Speed of execution (25%), price transparency (15%) were primary reasons for the buy-side when choosing to trade electronically.

Sell-side saw proof of best execution (22%), ticket size and firm prices (both 15%) as primary reasons their clients may chose to trade electronically.



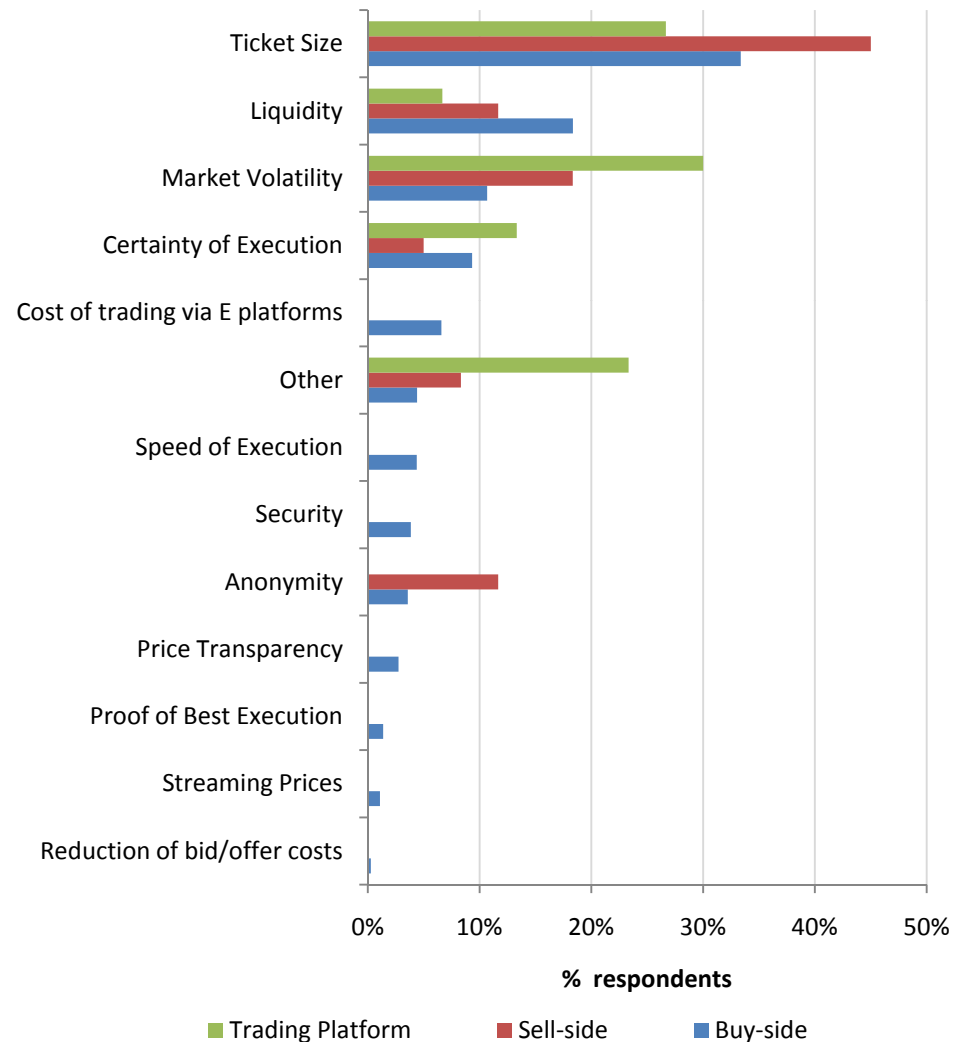
# afme / Keys Reasons For OTC/Voice Trading

Ability to trade in large ticket and liquidity remain primary reasons for voice trading:

- 33% of buy-side and 45% of sell-side respondents chose to trade by voice due to the ticket size.

Access to liquidity, market volatility and certainty of execution remain important reasons why investors trade OTC.

**Top Reasons for Choosing to Trade by Voice**

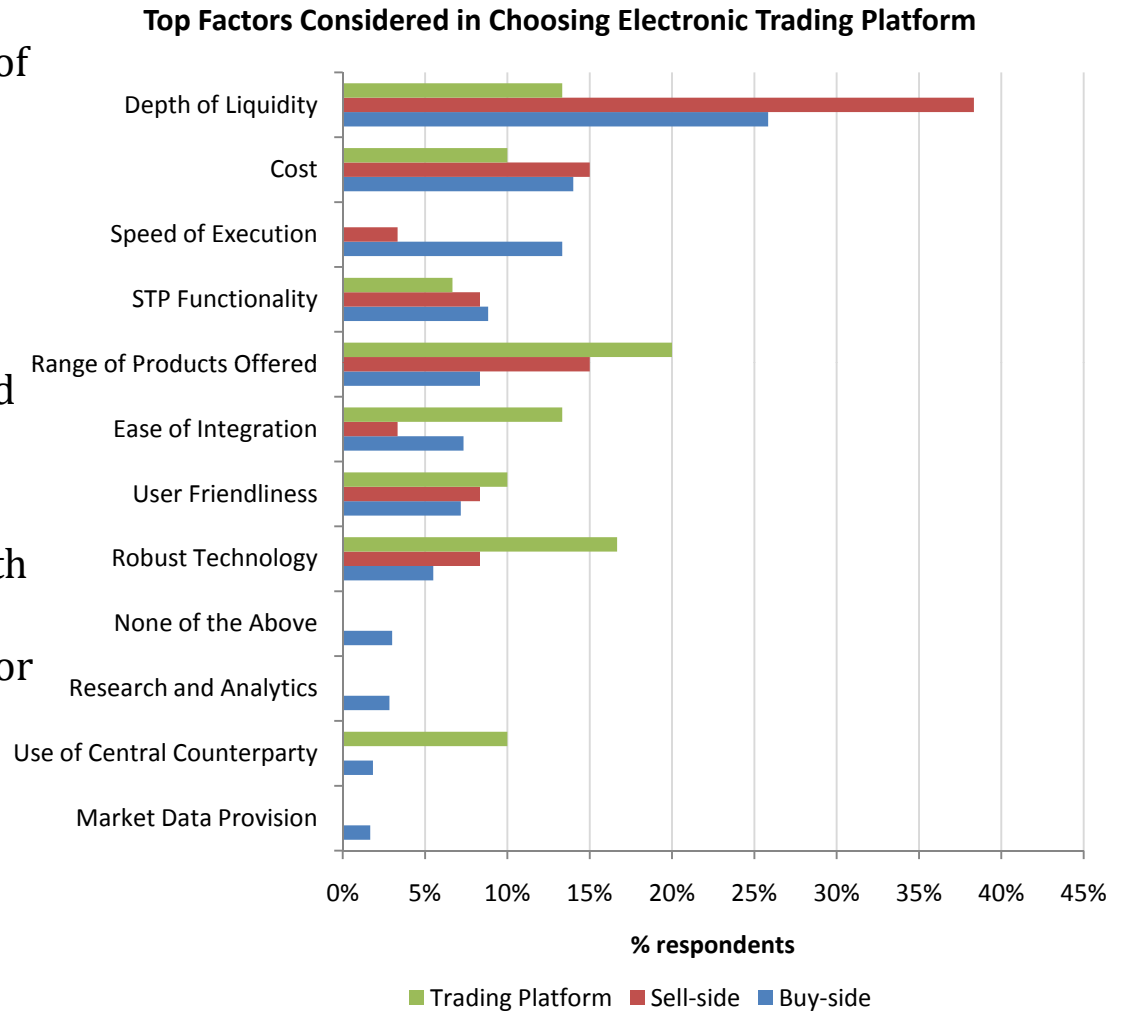


# afme / Top Factors When Choosing Electronic Trading Platform

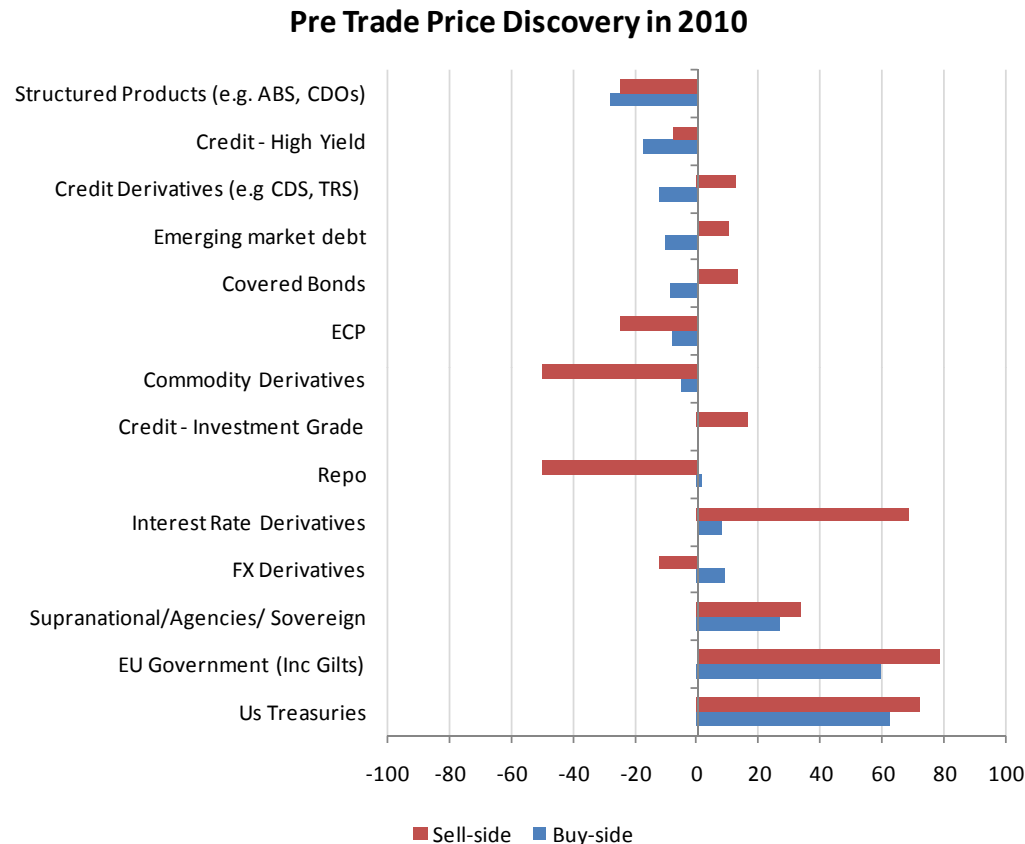
Buy-side participants (26%) and sell-side (38%) agreed that depth of liquidity was the most important consideration when selecting a trading platform.

13% and 12% respectively were also concerned with cost and speed of execution.

Sell-side and trading platforms both perceive the range of products available as a much higher factor for the buy-side.



# afme / Pre Trade Price Discovery in 2010



Buy- and sell-side rank pre trade price discovery for government bonds as excellent.

- Supranational and Agencies also rated highly overall by all participants.
- Structured Products and High Yield are seen as underperforming in terms of pre trade price discovery.

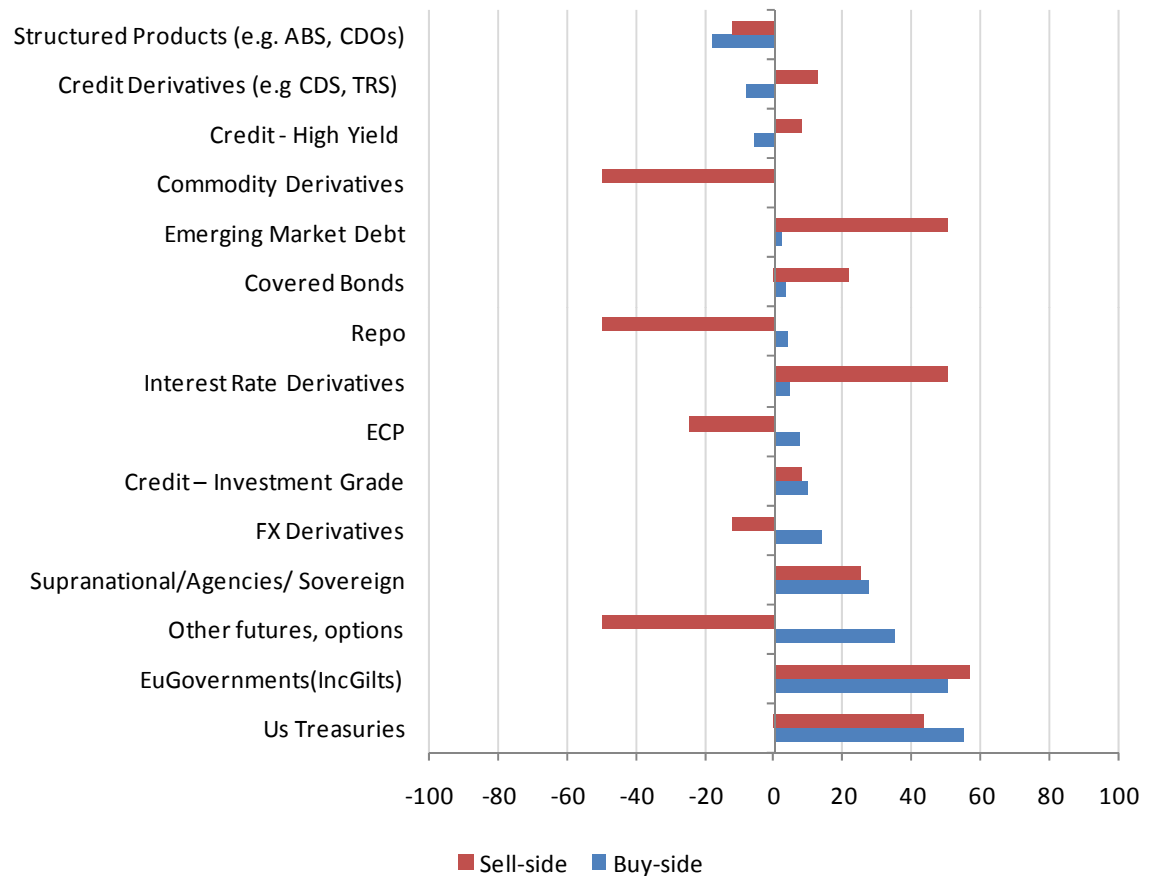
# afme / Post Trade Price Transparency in 2010

Buy-side and sell-side both rank post trade price transparency in EU Government Bonds highly.

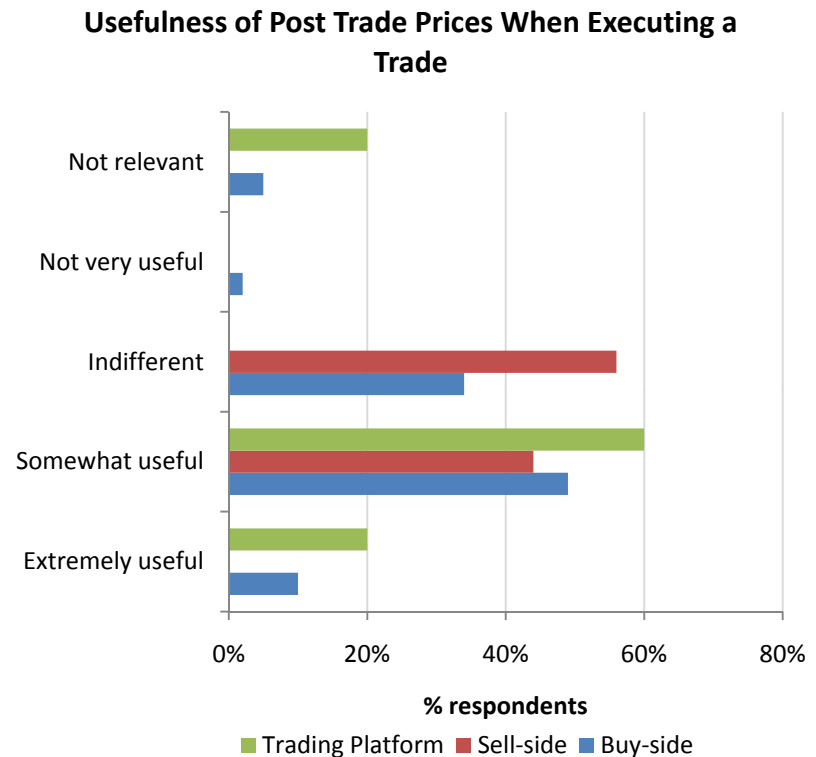
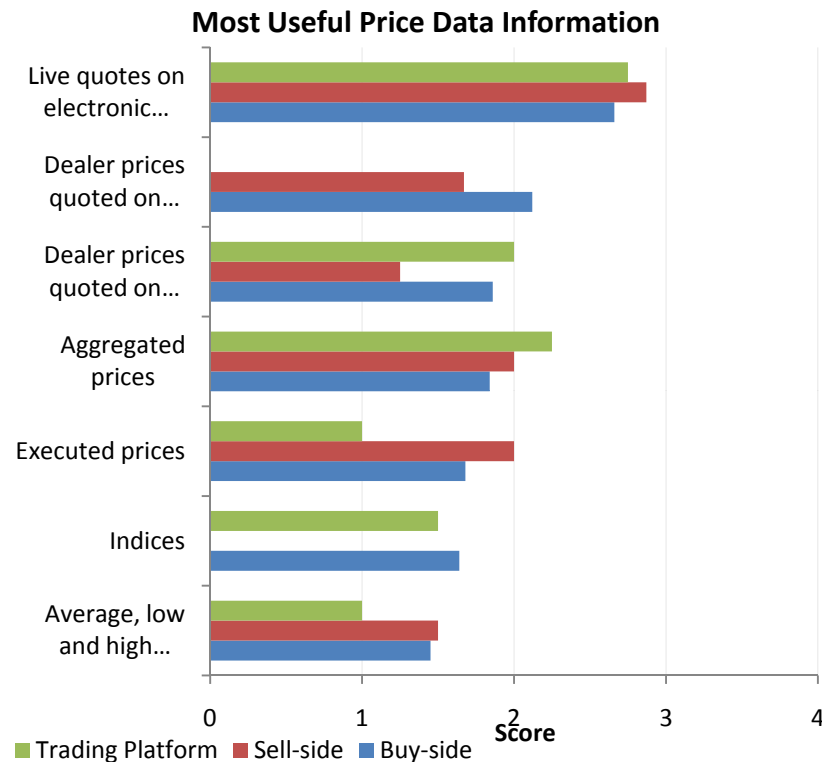
Buy-side perceive post trade transparency on Structured Products and Credit Derivatives as poor.

Sell-side rank post trade transparency as fair to good for IRD and Emerging Market Debt.

Post Trade Price Transparency in 2010

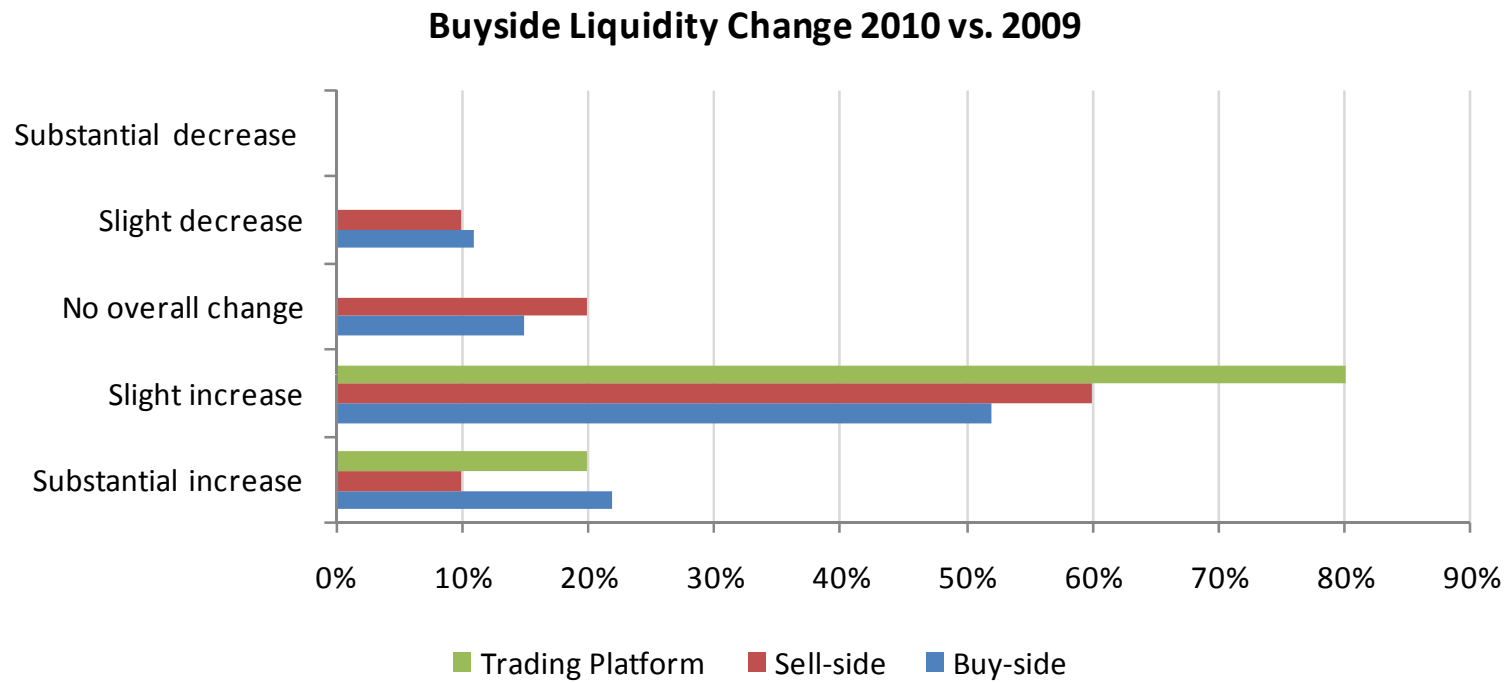


# afme / Usefulness of Price Data Information



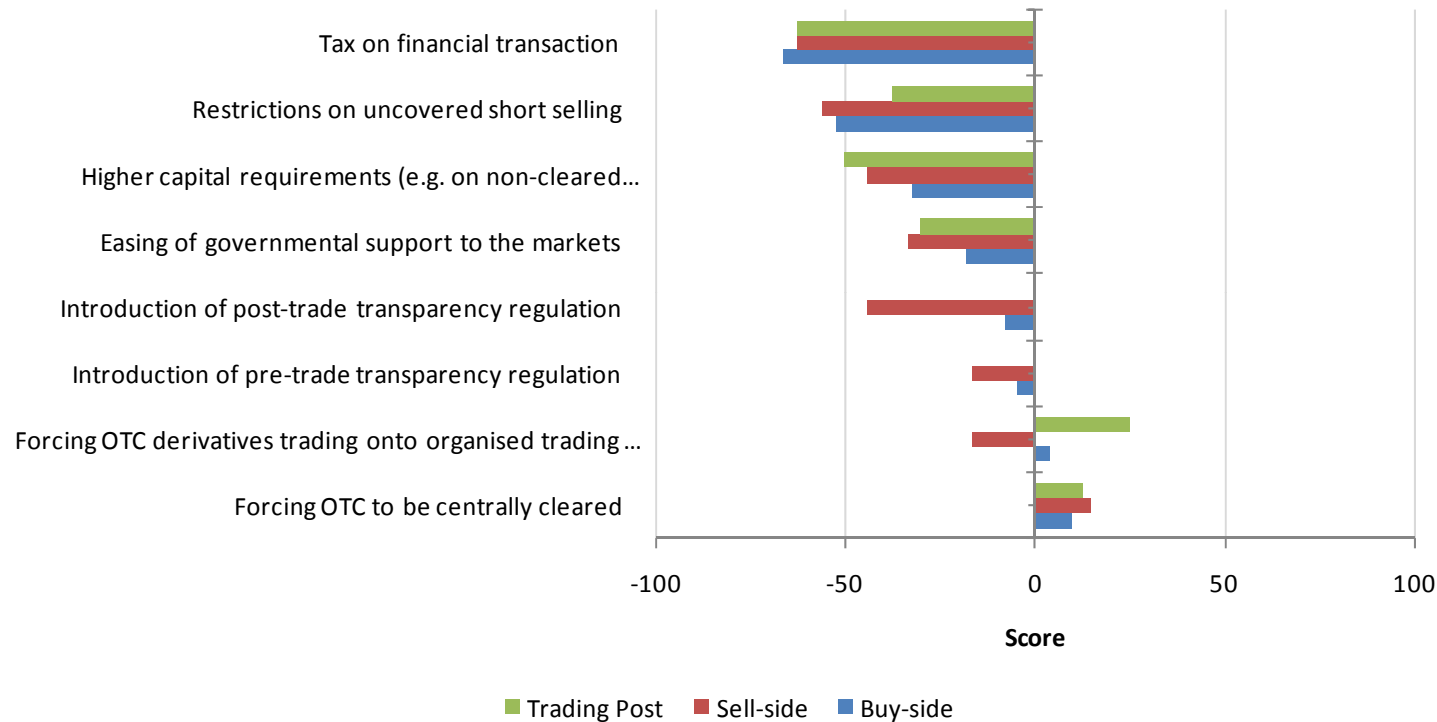
- All participants saw live quotes on electronic trading platforms as the most useful, followed by dealer prices provided by phone or on bid lists.
- 49% of investors saw post trade prices as somewhat useful when executing a trade; 41% however, were indifferent or found the information less relevant.
- Only 10% of buy-side saw post-trade prices as extremely useful for trade execution.

# afme / Buy-Side Liquidity 2010 vs. 2009



- Of the buy-side respondents, 74% percent saw an increase in liquidity in 2010 when compared to the previous year, (22% saw a substantial increase).
- For sell-side respondents, 70% saw an increase (10% observing a substantial increase).
- 11% of buy-side and 10% of sell-side saw a slight decrease in liquidity.

## Regulation and Potential Impact on Liquidity



- All participants have a largely negative view on most regulatory initiatives.
- All participants foresee a very negative impact of transaction tax on future liquidity.
- Buy-side and sell-side also see restrictions on uncovered short selling as significantly impacting liquidity.



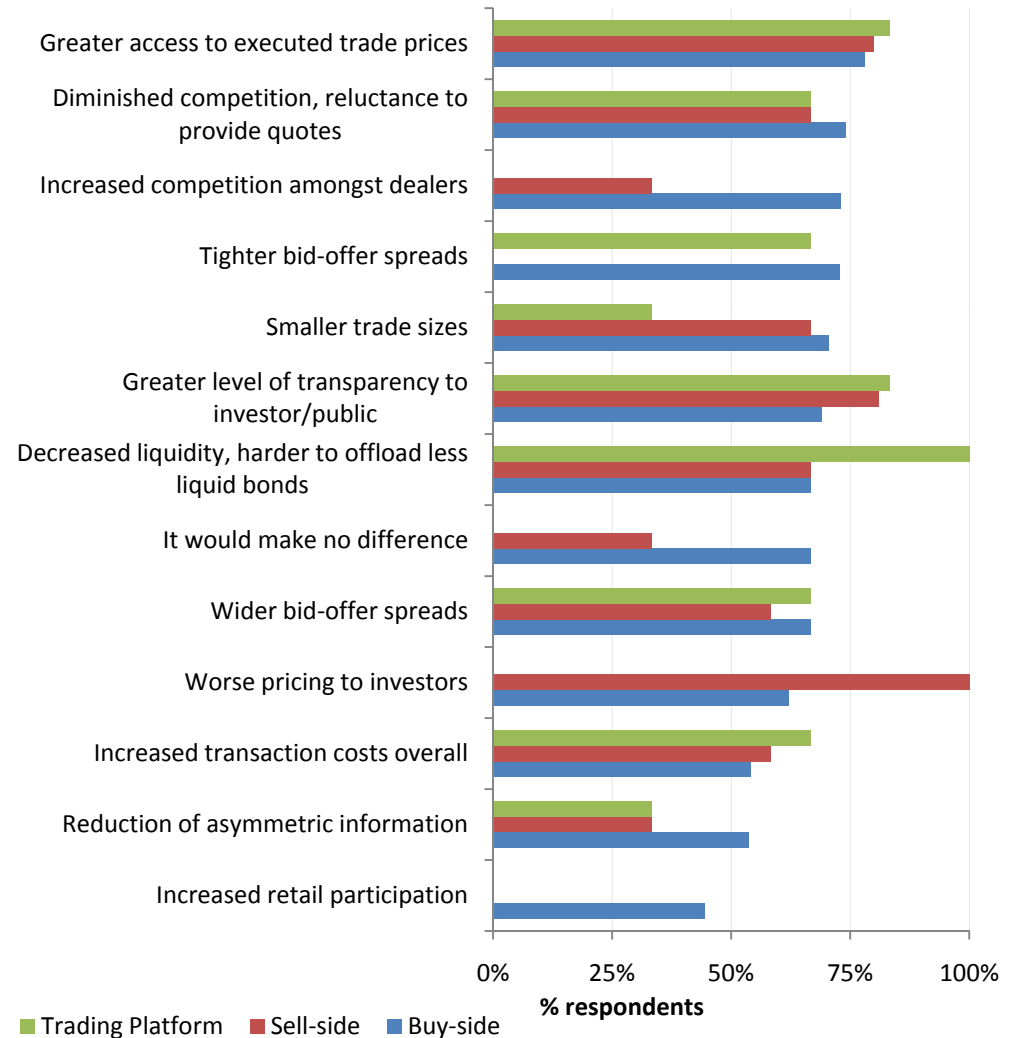
# afme / Impact of a TRACE-like System in Europe

Buy-side believe that a TRACE-like system could result in greater access to executed prices however could also diminish competition.

Sell-side respondents echo this opinion expecting worse pricing for investors.

Trading platforms foresee decreased liquidity and a market where it becomes harder to offload less liquid bonds.

Impact of a TRACE-like System in Europe



## 1. Electronic Trading

Continues to be a significant trading method but only modest growth seen in 2010. Majority of respondents expect to see an increase in volumes in 2011. By product areas, participants cited emerging market debt and investment grade credit, interest rate derivatives and repos.

## 2. Choosing an Electronic Trading Platform

Market participants agreed that depth of liquidity is most important when selecting a trading platform. Voice trading remains an important trading option with 'ability to trade in large tickets' and 'liquidity' seen as primary reasons for voice trading.

## 3. Price Discovery

Respondents see price discovery in Government Bonds as excellent and highly rate Supranationals and Agencies. Buy-side perceives post trade transparency on Structured Products and Credit Derivatives as poor. However, 41% of investors were indifferent to post-trade information or found it less relevant when executing a trade.

## 4. Impact on Liquidity – Market and Regulatory Factors

Participants mostly saw increased liquidity over the course of 2010. In terms of concerns for the future, participants have a largely negative view on most regulatory initiatives with Transaction tax and short selling regulations expected to greatly impact liquidity.

## 5. Future Transparency Regulation

Buy-side believe that a TRACE-like system could result in greater access to executed prices however could also diminish competition. Sell-side echo this opinion expecting worse pricing for investors. Trading platforms foresee decreased liquidity and a market where it becomes harder to offload less liquid bonds.

A stylized map of Europe is centered on a background with a vertical gradient from light green on the left to light blue on the right. The map is rendered in a dark, muted green color. The text "Thank You" is overlaid on the map in a dark green, serif font.

Thank You

1. The survey was sent out to a number of Investors, Dealers and Trading Platforms.
2. 61 Investors, 10 Dealers and 6 Trading Platforms completed the survey over the course of December 2010 to January 2011.
3. For questions where respondents were asked to rank their top three choices, the data was analysed such that 3 points was awarded to the first choice, 2 points to the second, and 1 point to the third. The weighted average results were represented in the charts.
4. For questions where respondents were asked to rank their views for a comparative list of options, the responses were converted to a score such that 100 points was awarded to option chosen as Extremely Positive, 50 points to Somewhat Positive, 0 points to Neutral, -50 to Somewhat Negative and -100 to Extremely Negative. The weighted average scores were represented in the charts.

- To promote safe, sound, and efficient wholesale financial markets that support economic growth, employment, and investment;
- To cooperate and engage constructively with stakeholders and policymakers toward ensuring open European and global markets that benefit from well-crafted, globally consistent regulations;
- To promote the adoption of market-led solutions, standards and practices; and
- To provide authoritative industry expertise and views for public officials, private individuals, and the media.

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