Discussion: “Bundling Trades in Over-the-Counter Markets”

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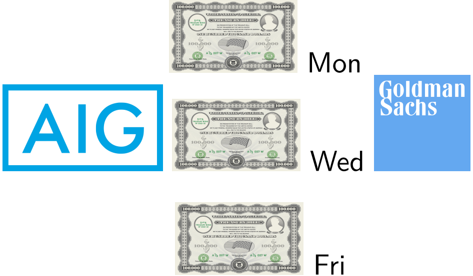
“Relationship”



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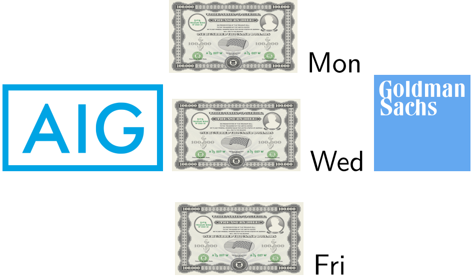

Six Facts

Multi-asset activity	Many institutional investors trade multiple asset classes
Few dealer connections	Investors concentrate their trades with a single "most-favored" dealer
Bundling prevalence	Trade bundling is common; switches dominate and are typically done with the client's preferred dealer
Platform enablement	Trade bundling, especially switches, is more prevalent on electronic platforms
Cost advantage	Bundles are cheaper than executing legs piecemeal; discounts are largest with switches and when trading with relationship dealers
Convenience premium	Bundles are cheaper on RFQ platforms than off, but switches are not; investors pay an estimated 0.10 bp "convenience premium" to execute switches electronically

Are bundled trades executed between same pair of traders?

- A dealer firm often assigns different asset classes to different traders, each trader has her own performance evaluation
- Challenge: Traders IDs not available
- More difficult to sustain relationship if executed between different pairs of traders
  - Human traders "own" a large share of relationship (Lee, Lucke, and Wang, work in progress)
- Get around: Are simultaneous trades from Client A more likely to be executed with the same dealer than non-simultaneous trades?
  - Yes $\implies$ intentionally bundling trades "at one stop"
- Remove dealer algo?

Convenience premium

- Fact 6: Switches are not cheaper on platform than off platform
- Explanation: Switches more exposed to adverse selection risk about specific bonds $\implies$ convenience premium dominates
- Question 1: Why is convenience premium not paid to the platform?
- Question 2: Single RFQs are equally exposed, but are cheaper on platform than off
- Does bundling lower transaction costs on platform?
  - No $\implies$ positive convenience premium

Some bundled trades are exposed to more adverse selection risk

- More adverse selection risk: "Butterfly" (yield curvature instead of overall level)
- Less adverse selection risk: A long list of diverse bonds (diversification)
- Can check how transaction costs differ
- Future work: Identify "informed client" using overall performance across asset classes
- Does bundling lower transaction costs between client-most-favored-dealer pair
  - Yes $\Longrightarrow$ bundling lower transaction costs above and beyond standard "relationship discount"

Summary

Great data and many thought-provoking new facts

Main suggestions:

- More direct evidence for the relationship mechanism
- More discussion on convenience premium
- Distinguish bundled trades with higher vs. lower adverse selection risk