Goldman Sachs comes late to the game

The *Financial Times* ran a story Monday about Goldman Sachs becoming the first big dealer to orient its business around electronic fixed-income trading and away from "hands-on" order processing in light of new regulations coming from Dodd-Frank. The story claimed that Goldman was a pioneer in this approach:

> Now Goldman could be one of the first banks to fully introduce electronic trading for its FICC business, marking an important departure for the unit, which has traditionally prided itself on "high touch," or traditional trading, undertaken by desk-based brokers on behalf of the bank's clients.

This is laughably inaccurate. Electronic trading in fixed income is ubiquitous and likely will rival the penetration of electronic trading for equities within several years. I've personally worked on issue of electronic trading for fixed income since 2001. My work was done in conjunction with an industry standards group, FIX Protocol, which is a trading protocol most well-known for its use in high frequency equity trading.

In December 1999 Putnam Investments teamed with Merrill Lynch to develop a "proof-of-concept" to migrate the FIX language from electronic equity trading to electronic fixed-income trading. The experiment was successful and led to the development of a working group for FIX which had the support of the Bond Market Association, the precursor to SIFMA. The group was formally organized in 2000 as the Fixed Income Working Group (FIWG) and is now known the Global Fixed Income Committee.

The work of the FIWG was originally driven by several dealers (although not Goldman Sachs) and the staff of Tradeweb and MarketAxess, the two dominant institutional fixed-income trading platforms. These two platforms are configured for dealers to compete for customer orders from the institutional buy-side — think mutual funds, non-dealer banks, pension funds and others. You can think of these alternative trading systems (ATS) as similar to exchanges where dealers have the inside edge on technology and access to order flow. But they are not regulated as exchanges by the SEC and do not enforce rules on their participants. They are essentially dark pools since they are not required to display or report prices for executed trades for many bond classes (trades in corporate bonds, mortgage-backed securities and agency bonds are reported to FINRA's TRACE, which publishes an unattributed aggregate trade tape for corporate bonds only).

In 2001 FIX Protocol signed a statement of understanding (page 21) with the Bond Market Association making FIX the standard for electronic trading of fixed income and things took off from there. There were an increasing number of sell-side and buy-side fixed-income market participants who became involved in developing and adopting the FIX standard for bond trading. Curiously, Goldman Sachs was rarely, if ever, involved with these meetings. In 2006, I published the FIX Kit, a short guide for firms to understand the basics of using FIX to trade fixed income and connect to their counterparties. On page 15 you can see the dealers who had FIX connections available in 2006 for their customers. The list includes Credit Suisse, Barclays, Deutsche Bank, JP Morgan, UBS and the late Lehman Brothers. Notice the conspicuous absence of Goldman Sachs.

The FT article says that Goldman is specifically looking at the rates and currencies markets to go electronic. But these two markets conduct almost all trades electronically already. Rates trading is done through Tradeweb with over a million price updates a day for users. Electronic trading for currencies is already heavily electronic and was migrating towards algorithmic trading in 2008. Foreign-exchange trading is one of the easiest to automate because there are limited currency pairs to trade. The first platform for electronic currency trading, Matchbook FX, was established in 1999 by a former Goldman Sachs foreign-exchange trader, Josh Levy.

I have the impression that Goldman Sachs often lurks around waiting for technologies to develop and stays out of the game until its ripe. This is wholly different than being a "pioneer' as the FT article claimed. I think one takeaway from this episode is that financial media needs to do a little better job of searching out the core truths of a story. This is not an issue that afflicts only the *Financial Times* — I see journalists from every media outlet easily spun by dealers on complex issues, especially those that relate to technology and regulation issues. It's a substantial problem because the majority of financial market activity happens away from regulated exchanges in the vast, dark "over-the-counter" markets.

My advice to financial journalists is question everything and if information comes willingly from a dealer assume they are spinning you.

This was written by cate. Posted on Wednesday, March 28, 2012, at 12:59 pm. Filed under Liquidity, Open engines, Trading. Tagged Goldman Sachs. Bookmark the permalink. Follow comments here with the RSS feed. Both comments and trackbacks are currently closed.

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