Title: **TRANSACTION COSTS, TRADE THROUGHS AND RISKLESS PRINCIPAL TRADING IN CORPORATE BOND MARKETS**

Speaker: **LARRY HARRIS**
University of Southern California

Importance: Why this matters:

Because they are hidden in netted transaction prices, the cost of trading fixed income securities has historically been quite opaque. Recent advances in availability of trade and quote prices allowed Harris to identify riskless principal trades (RPTs). He demonstrated that dealers who arrange RPTs effectively act as brokers, while charging clients amounts more consistent with riskier dealer trades.

Investigation: "Speaker analyzed XXX data to address the questions yyy, zzz, etc."

Harris compared the data on 3 million TRACE trades with about 464 million NBBO quotes from various electronic trading venues.

He was able to pair buy trades with sell trades within 2 seconds to identify those trades which were likely crossed through a dealer. He estimates the average customer roundtrip transaction cost at 125bp, equivalent to four month's interest on a 4% bond, also equivalent to a 50¢ spread on a $40 stock!

Innovation: Are there new techniques of interest in the data or approach to the problem?

Harris has assembled a rich database capable of addressing transactional issues on corporate and municipal bonds.

Insights: 1-2-3, what are the three most important things the speaker offered?

1. Opacity in transaction costs has resulted in excessive costs, particularly to smaller investors who do not have the leverage, access or experience to query multiple dealers.

2. Most investors cannot effectively offer liquidity in these dealer markets. Institutional arrangements effectively prevent most retail customers from benefiting from innovative trading technologies.

3. Bond markets would benefit greatly from having a National Best Bid and Offer facility. Experience in equities is that order handling rule innovations have vastly improved those markets. Investors would benefit from lower costs; dealers would benefit from rising volume; and higher liquidity would make bonds more valuable, thus benefiting issues.

Audience rating: 4.89