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Forex algos revive US rates trading at UBS

Rejigged algo behind doubling in volumes – Swiss bank aims to repeat trick in swaps.

A European bank with a slimmed-down product line is making waves in the US Treasury market – and the unlikely secret of its success is an algorithm borrowed from its foreign exchange business.

UBS, which announced a retreat from fixed-income trading in 2012, claims to have more than doubled its market share and revenue from electronic trading of liquid US Treasuries since last year, but the starring role for a forex pricing algorithm is raising eyebrows: "I don't know how you could use a forex algo to trade rates – the two markets are so different," says one former rates trader who now runs a hedge fund.

Dylan Roy, head of US rates trading at UBS, says the firm has seen "a dramatic uptick in market share and volume" in recent months, after it switched on its new pricing algorithms.

Clients back that up: "We've seen an improvement in their pricing, and because of that they have earned more of our business," says a New York-based rates trader at a large Asian financial firm.

Two other firms make similar comments.

It is a dramatic turnaround in the fortunes of a business that, at this time last year, ranked 16th in volume and number of trades on Bloomberg, the largest platform for dealer-to-client trading in US Treasuries. Last month, UBS was eighth in volume and fifth in number of trades.

Buy-side firms, which have complained of spotty liquidity in US Treasuries, are taking notice. "We have seen UBS winning deals, and it's not a counterparty we were trading with a year ago," says the head of trading at a US asset management firm.

For April, UBS had the best hit ratio in tickets on Bloomberg across active US Treasuries – meaning it won more trades on which it was asked to quote than any other dealer – and a quicker average response time than all but one of its competitors.

The surge in the rankings comes on the heels of a radical overhaul of the firm's US Treasury pricing algorithms, which was completed in the fourth quarter of 2014. UBS essentially scrapped its old US rates platform and replaced it with a revised version of its engine for currency trading, where it is a top three player. It plans to repeat the trick in interest rate swaps, where Citadel Securities is already shaking up the competitive landscape with algos that are beating incumbent dealers on both price and speed.

"The idea was to take the infrastructure and general pricing engine that was being used for forex and to apply it to the rates business," says Giuseppe Nuti, executive director responsible for algorithmic trading at UBS.

Although dealers are increasingly turning to their forex businesses for lessons on how to make fixed-income trading more capital- and cost-efficient, most – if not all – are said to retain separate pricing engines.

Nuti says the forex engine needed some tweaks – aside from the fact that fixed income has a yield curve and currencies do not, forex is largely a streaming market whereas dealer-to-client trading is rates is mainly request-for-quote – but he insists the underlying mechanics "are almost identical".

The result, according to Nuti, is a rates platform with the "speed and robustness" found in forex trading.

"A top-three forex player sees vastly higher volumes than the top firms in the Treasury business. One of the things we've noticed since we started using this technology is that during excessively volatile times, we tend to do much better than our competition," he says.

UBS recorded some of its highest hit rates on October 15, 2014 – when US Treasuries saw a violent intraday swing – and on January 15, in the frenetic trading that followed the Swiss National Bank's decision to abandon its currency cap.

"We see more clients coming to us when other firms are stepping back. Our system can withstand these moves because it's already been through the mill in forex. It can handle the flows on the most volatile days without any problems," says Roy.

UBS attributes this to the fact that the forex system pulls pricing data from a wider range of sources than a typical rates algorithm. "We are less reliant on data from one or two exchanges, which recently have been very volatile," says Nuti.

The bank claims its rates algorithms are also now among the fastest on the Street. The firm's average response time of 0.42 seconds in April ranked second on Bloomberg and compares to a market average of just over 0.9 seconds. Its average response time was slightly above one second at this time last year.

Roy says gaining market share in liquid and active US Treasuries – benchmarks and single-, double- and triple-olds – is consistent with the firm's strategy of avoiding heavy balance-sheet usage.

"We want to be very good at trading liquid instruments, and that includes Treasuries with a duration of greater than two years, from currents all the way to triple-olds. We have a high velocity of distribution in those products and we're not using a lot of balance sheet resources."

Roy says UBS also intends to deploy its re-jigged forex algorithms and infrastructure in other rates products, including interest rate swaps.

"We have designs on adding swaps to this suite and increasing the portfolio effect. In forex, you have dollar/euro correlated to dollar/sterling. But dollar swaps are far more correlated to Treasuries than many of the currency pairs we use to hedge in forex. We're pretty optimistic about the portfolio effect of adding swaps to this in the next six months or so."

Some on the buy side appear ready to give the bank another chance. "They fell off our radar," says an executive at a fixed-income hedge fund. "When we're trading, we go to the firms that are providing balance sheet. Our rates trader doesn't even know who our coverage is at UBS anymore – it's been that long since we traded with them.".

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