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MARKET STRUCTURE

An Empirical Study of Bond Market **Transactions**

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systematic differences exist in exchange transaction prices and dealer-market quotes

relative to transactions in the dominant dealer market. We were able to perform such research for the first time because data were recently made available on transactions from both markets.

The dealer and exchange markets represented here provide very different environments in which similar (in many cases, identical) securities trade. The exchange is a transparent electronic limit-order market, and the dealer market is characterized by a lack of transparency. Investors have an obvious interest in knowing about bid-ask spreads in different markets, but also important is the degree to which bid-ask spreads and their determinants differ between these markets.

To carry out the study, we used transactions reported to the National Association of Insurance Commissioners by all insurance companies (which are the largest group of counterparties to dealer-market bond trades) and transactions and bid-ask quotes from the NYSE's Automated Bond System (ABS). Surprisingly, despite the large size differences in transactions between the dealer and exchange markets, we found estimates of effective bid-ask spreads in the markets to be quite similar. Per \$100 par value, investment-grade corporate bonds have average spreads of about 13 cents in the dealer market and 20 cents on the ABS for trades of 10 bonds or more. High-yield bonds (below a Baa rating) have spreads of about 19 cents (per \$100 par value) in both the dealer and ABS markets. These spreads are smaller than estimates found in a study

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bid-ask spreads and the magnitude of price discrepancies for all classes of bonds are reliably associated with proxies for risk and liquidity.		
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