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How Chi-X changed the landscape for Aussie investors



John Fildes... "We have grown faster than any other alternative trading venue anywhere in the world since our platform was launched."

When Chi-X Australia commenced full operations in November 2011 it set in train a number of positive developments for investors, including an improvement in the offerings of the former monopoly exchange, the ASX. Greg Bright spoke with John Fildes, the Chi- X Australia Chief Executive Officer, about the exchange's development and its future.

One of the important objectives of Chi-X, the "other" stock exchange, which recently hit a daily volume of 27 per cent of all listed trades in Australia, is to be disruptive. And that it has been.

John Fildes, who has been Chi-X Australia's CEO for the past 15 months, says that without competition companies get lazy. The competition Chi-X is providing is being increasingly appreciated by both institutional and retail investors.

Fildes, who spent much of the formative years of his career in Asia before settling in Sydney to be with his Australian wife Kristin, could add that an objective, also, was to persevere. It took Chi-X the best part of four years, from March 2008 to October 31, 2011, to become fully approved by the regulator and ready to go.

Chi-X's parent company is owned by several institutions and big users of its services with platforms in Japan, Canada and Australia. Chi-X's first market was Europe in 2008, where the platform was acquired by another alternative markets operator, BATS, and now operates as a wholly owned BATS subsidiary, BATS Chi-X Europe. Chi-X owners include the Nomura subsidiary Instinet, UBS, Merrill Lynch/Bank of America, JP Morgan, GETCO and Morgan Stanley. Fildes had worked with Morgan Stanley in Hong Kong and then GETCO, in Singapore. He was on the board of the parent, Chi-X Global, and heard that the previous managing director in Australia, Peter Fowler, who had started the long slog to get approval for the exchange, was about to retire. He pitched for, and got, the job.

"Long before we actually got our license and started operating, we could see that the Australian landscape was going to become more competitive," Fildes says. "The ASX cut prices for its equities trading fees, it started to invest more in its platform and to launch new products. Australian investors are the big beneficiaries in all of this, as trading costs have been reduced and service offerings improved."

Stock exchanges around the world have gone through massive change in the past decade or so, with new ownership structures, takeovers and intense competition. Technology is a big driver, especially in capturing the increasingly important algorithmic trading market.

Fildes says, for instance, that in the past a "passive" trader could take 25 minutes to get to the top of the queue to buy or sell even a large liquid stock such as Telstra. "That's a very long time," he says. Given that most brokers use algorithms, and slice their orders up, there is a chance that they may "go aggressive" and cross the spread, which will cost them money. Chi-X, he says, offers better prices, on average, if an investor decides to go aggressive.

Its three main benefits for the market are: it has market makers to tighten spreads; it offers price improvement because the mid-point is integrated into a central order book; its queue times are less.

Notwithstanding the general improvements for investors since Chi-X's arrival, Fildes believes the Australian market still suffers from lack of liquidity.

"People often quote turnover velocity," he says. "But that's because we have a high free- float component. In Australia, free float is about 90 per cent compared with, say, Hong Kong at about 45 per cent. On a free-float weighted basis we are behind Hong Kong, Singapore and Japan."

Chi-X offers trading in all of the 2,100 ASX-listed companies. On a typical day it will see trading in about 600 of them and quotes in about 1,000. There are a large number of illiquid stocks, however. "Even with the ASX/S&P 300, it tends to fall away after the top 50 stocks," he says.

Notwithstanding its blue-blood owners, Fildes says there has been a lot of pressure on Chi-X to reach breakeven financially.

“For the last few months we’ve been profitable,” he says. “That’s a great achievement after less than three years... We have grown faster than any other alternative trading venue anywhere in the world since our platform was launched. In Canada, it took five years to reach the same market share that we have now.”

While institutional investors make up the largest component of any market, Fildes says that Chi-X took a slightly different approach to its launch period in Australia than elsewhere. It set out to have a mix of users right from the start.

“Having retail investors is absolutely crucial to a trading venue,” he says. “You need people taking different views. You need retail, hedge funds, alternative managers, etc. You don’t want everyone wanting the same thing at the same time.”

About 30 per cent of the aggressive flow on Chi-X is retail. High frequency traders make up the largest component of passive flow but that is declining, Fildes says, as more institutional investors post their passive trades with Chi-X.

“It’s not very often that they’ll get a worse price [with Chi-X],” Fildes says. “Retail brokers are all using smart order router systems, which means that they’ll only send us the order when they can see a better price.”

He believes that another reason for Chi-X’s success is that it has spent a lot of time talking to its clients and potential clients.

“You really have to listen to clients, not tell them what you are going to give them,” he says. “I think the ASX has done a great job for its shareholders, but not necessarily its clients. It has the highest EBITDA of any exchange in the world and a 90 per cent dividend ratio. But I think stock exchanges should be a growth investment, not a yield one... Chi-X has been additive to the market. We have brought new ways to trade, we’ve lowered costs and we’ve introduced efficiencies.”

Fildes promises more of the same in 2014, with service enhancements and new products planned for the rest of the year.

“We’re unashamedly competitive and client focused. Enabling competition is invariably the best way for consumers to get a better deal, and grow Australia’s investment and financial sectors.”