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Banking & Finance: Wall Street-Backed Exchange Launches --- New trading place is expected to be a formidable competitor to NYSE and Nasdaq

By Alexander Osipovich

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A new exchange backed by Wall Street banks, electronic-trading firms and asset-management giant BlackRock Inc. launched Monday, introducing a new, low-cost competitor to the New York Stock Exchange and Nasdaq Inc.

Members Exchange, or MEMX, executed its first trade at 7:48 a.m. ET, with 100 shares of Consolidated Edison Inc. changing hands for \$73.90 a share. Initially the exchange will handle trades in seven stocks, including Alphabet Inc. and Exxon Mobil Corp. On Sept. 29, MEMX plans to extend trading to all U.S. exchange-listed securities.

Traders and analysts expect MEMX to be a formidable competitor to the incumbent exchanges. The New Jersey-based startup has raised more than \$135 million from firms including Charles Schwab Corp., Citadel Securities, Goldman Sachs Group Inc. and Virtu Financial Inc. Backers of MEMX are expected to direct some of their trading activity to MEMX, helping it get off the ground.

"There hasn't been a launch of a new market in U.S. equities for a long time that's had as good a chance of success," said Matthew Andresen, founder of Headlands Technologies LLC, a trading firm that isn't involved in the MEMX launch.

Nearly 60% of U.S. equities trading volume is handled by three exchange groups: NYSE, owned by Intercontinental Exchange Inc., Nasdaq and Cboe Global Markets Inc.

The consortium behind MEMX came together after years of frustration among banks and trading firms with the fees charged by the major exchanges. Many Wall Street firms say the exchanges abuse their dominant position in the marketplace to overcharge for market data and other key services. The big three exchange operators say their fees are reasonable and deny abusing their market power.

MEMX plans to undercut the big exchanges on price, initially giving away its data.

New exchanges often fail because traders gravitate toward markets where there are already many other participants to trade with -- a powerful factor in favor of incumbents. MEMX hopes to attract trading activity with a lavish promotional-pricing scheme. Drawing on its cash hoard, it will pay out more in rebates than it collects in transaction fees. Such a strategy means MEMX will lose money, at least initially, as it tries to build a liquid marketplace.

"We're prepared to be aggressive and lose money on every transaction to get people to participate," MEMX Chief Executive Jonathan Kellner said in an interview.

MEMX will also use new **technology** built from scratch to provide a better trading platform than those offered by the established exchanges, Mr. Kellner said. MEMX's tech team includes veterans of Nasdaq and Virtu.

Initial discussions among MEMX's founding firms began more than two years ago. Since then, it has brought on an array of investors that reads like a who's who of Wall Street. Other backers include Bank of America Corp., Citigroup Inc., E*Trade Financial Corp., Fidelity Investments, JPMorgan Chase & Co., Morgan Stanley, TD Ameritrade Holding Corp., UBS Group AG, Wells Fargo & Co. and high-tech trading firm Jane Street Group LLC.

Still, there's no guarantee MEMX will succeed. Incumbents like NYSE and Nasdaq may respond with aggressive rebates and price schemes of their own to avoid losing market share, said Shane Swanson, senior analyst at research firm Greenwich Associates.

"It's a highly competitive environment," Mr. Swanson said. "The other exchanges aren't going to just sit there."

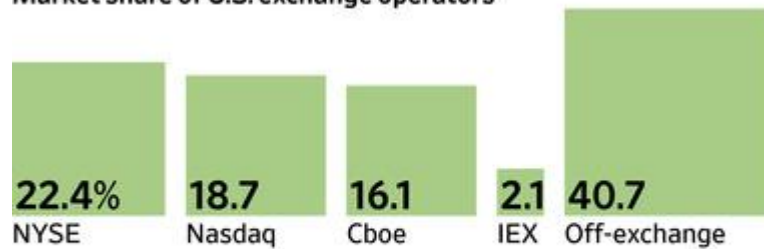
MEMX's rollout comes amid a flurry of launches of new U.S. stock exchanges.

These include the Long-Term Stock Exchange, which went live in late August. LTSE, which is backed by an array of Silicon Valley entrepreneurs and venture-capital firms, plans to list companies that favor long-term strategic thinking over hitting short-term financial targets.

On Friday, options-exchange operator Miami International Holdings Inc. plans to kick off trading at its first U.S. stock exchange, called MIAX Pearl Equities, which is being positioned as a low-cost, tech-savvy competitor to the NYSE and Nasdaq.

Yet another startup, called Dream Exchange, plans to apply for stock-exchange status with the Securities and Exchange Commission next year, according to its founder and CEO, Joe Cecala. Dream Exchange aspires to be a listing venue for early-stage companies, with an emphasis on minority-owned businesses.

Market share of U.S. exchange operators



Note: Figures show percentage of U.S. equities trading volume this year executed by various exchange operators. Based on data through Sept. 17.

Source: Rosenblatt Securities

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Trading slivers of individual shares has become a fervent pursuit for thousands of individual investors, amplifying the 2020 rise of pricey yet popular stocks like Amazon.com Inc. and Tesla Inc.

Fidelity Investments, which rolled out fractional trading to customers in January and February, says more than 340,000 of its accounts have placed a fractional trade, in which the customer buys or sells less than an entire share. Interactive Brokers Group Inc., another online brokerage, says around 117,000 users have enabled fractional trading since the firm released the feature to individual investors in November. Charles Schwab Corp. says more than 60,000 accounts have bought its "Stock Slices" since it turned on the feature in June.

Fractional trading has become widespread as stock splits have fallen out of favor among some of America's hottest companies and the coronavirus pandemic has intensified the appeal of top **technology** companies, pushing share prices of many market leaders into the hundreds or thousands of dollars.

One of the most discussed trends in markets this year has been individual investors' renewed embrace of stocks, motivated in part by coronavirus-fueled volatility and free trading apps like the one from Robinhood Markets Inc. Proponents say fractional trading has helped democratize access to the stock market.

But it may be encouraging risky speculation that some analysts and academics warn will end with many individual investors losing money. The S&P 500 has surged nearly 50% since March, despite a rise in U.S. unemployment and other significant, unresolved economic problems.

"I can buy stock in companies I could never afford," said Jacob Gonzalez, 34 years old, who trades fractional shares on Fidelity and Robinhood. "I've got Tesla now. I've got Amazon."

In about 80% of fractional trades, Fidelity says, the customer specifies a dollar amount -- for instance, spending \$500 to buy a slice of a share of Amazon, which closed at \$3,225.00 a share on Thursday.

Fidelity customers can also specify what percentage of a share they want to buy.

Robinhood wouldn't disclose how many customers use fractional trading, but it says millions of people joined a wait list for fractional trading after the company unveiled plans for the feature in December. Since then, the most popular stocks for fractional trading at Robinhood have been Tesla, Amazon, Apple Inc., Microsoft Corp. and Netflix Inc., a company spokeswoman says. Shares of those companies are each up at least 37% this year, compared with a 3.7% rise in the S&P 500.

Mr. Gonzalez, a resident of Chino Hills, Calif., said he lost his information-**technology** job in March and has less than \$10,000 in his portfolio. He recently began doing deliveries for food-delivery service DoorDash. A proponent of cannabis legalization, Mr. Gonzalez said he often spends \$4.20 on stock purchases. The number 420 is a popular slang code for cannabis consumption among marijuana enthusiasts.

Kelli Hernandez, a 31-year-old in Salem, Ore., joined Robinhood this year and bought stocks including Novavax Inc., which is developing a coronavirus vaccine. In June, Robinhood gave her access to fractional trading. Ms. Hernandez, who works as an operations manager in a nursing home, has used the feature to add more Novavax -- whose share price has surged this summer -- and to invest in Amazon, Apple and Netflix.

"If I could turn that around and buy a nice rocking chair for my nursery, that would be a win for me," said Ms. Hernandez, who is expecting a baby this fall.

The ability to hold fractional shares isn't new. Investors have been able to amass portions of shares for decades through dividend-reinvestment plans, in which a company's dividend payouts are plowed back into purchases of its shares. What is new is the ability to freely trade partial shares during market hours. Brokers

like Fidelity and Robinhood can now execute fractional orders immediately, much as they execute ordinary orders to trade stocks or exchange-traded funds.

Research has shown that trading frequently isn't good for investors, and a simple buy-and-hold strategy works best over the long run. Fractional trading will likely tempt some novice investors to try stock picking, said Terrance Odean, a finance professor at the University of California, Berkeley. Still, he added, that shouldn't be excessively risky, because such investors generally buy small quantities of stock.

"Will this encourage some speculation? Probably some," Mr. Odean said. "But it's going to be speculation with a lot less money than if people were forced to buy whole shares."

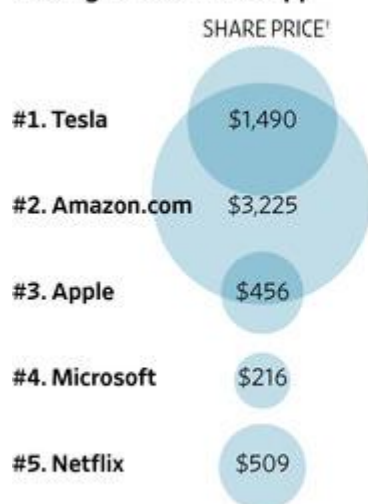
Besides the big online brokerages, an array of financial-**technology** startups offer fractional trading, including M1 Finance LLC, Social Finance Inc. and Square Inc. One app based on fractional trading, Public.com, is backed by investors including Hollywood actor Will Smith's venture-capital firm and National Football League star J.J. Watt.

Not all apps work the same. M1 and Social Finance's SoFi app execute fractional trades only once or twice a day, accumulating customer orders to buy or sell slices of stock and executing them together. That exposes investors to the risk that a stock price could swing sharply in the hours between when the order is placed and when it is filled.

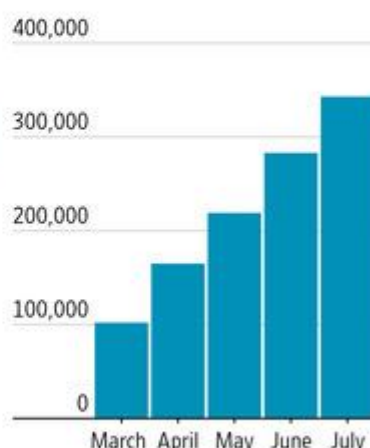
An M1 spokesman said the firm caters to long-term investors and its approach discourages unproductive trading. A Social Finance spokesman said the firm was working on supporting real-time execution.

Fractional trading has surged in popularity. Many investors are using it to buy high-priced stocks, such as Amazon.com and Tesla.

Top five stocks for fractional trading at Robinhood app*



Number of accounts at Fidelity Investments that have done fractional trades†



*Based on number of customers who have traded the shares since introduction of fractional trading in December; through Wednesday. †Prices as of Thursday. ‡Fidelity introduced fractional trading for all of its customers in February. Sources: Robinhood (ranking); FactSet (prices); Fidelity (accounts)

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