China's CHX foothold in US capital markets?

It is 30 years since the last "Asians are Coming" scare washed across the US. At that time it was the Japanese newly minted with the title of Global Economic Dominator and having the World's Largest Bank that were feared for their purchase of the iconic Rockefeller Center and various golf courses around the US. The rest is of course history with the Japanese economy only having a very brief day in the sun before tumbling into deflation and disdain (though bumbling along quite nicely ever since). Now it is the Chinese who are the feared economic invaders.

With the current distraction being the Muslim "threat", the Chinese have competition for the title as the Great Satan of xenophobes. As a result their latest deal has not attracted the nativist outbursts one might have expected a couple of years ago when the US was perceived to be on a back-foot *via a vis* China. Even more poignant is the lack of a counterattack from those who capital markets, as we suspect many would like to see more competition for entrenched quasi-monopolies in the equities trading world.

The Deal

Late last week the Chicago Stock Exchange, Inc. announced that it had entered into a definitive agreement to be acquired by an investor group led by Chongqing Casin Enterprise Group. However no details were offered of price or conditions, although Bloomberg claimed to have a source close to the deal saying the price did not exceed $100mn. The deal was unanimously approved by the Exchange's Board, but the sale remains subject to regulatory approvals. The acquisition is expected to close in the second half of 2016.

Founded in 1882, the Chicago Stock Exchange, more jazzily referred to as the CHX, is one of the nation's oldest full-service national securities exchanges with strength in high-performance technology trading. CHX offers a compact set of order types and trading functionalities, such as CHX|snap, designed to provide a level playing field for all market participants.

Chonqing Casin Group is a privately-held diversified holding group founded in 1997 with headquarters in Chongqing, China. The group's founder and chairman is Shengju Lu, who reputedly was a torch bearer during the Beijing Olympic Games in 2008. The company is focused on real estate development, environmental protection industry investment and operation, financial holdings and municipal infrastructure investment and construction. By Chinese standards it is relatively small with only 821 employees, though it has operations across China and abroad, including Beijing, Hong Kong, Sydney and other locations.

Casin has a fairly low profile up until now. We found a record of a deal in November 2015 when it acquired Sino-Australian International Trust Co., Ltd., based in Shanghai, which provides non-banking financial services, including arranging finances for companies and local government bodies. Bloomberg reported that in 2012, the firm increased its stake in Shenzhen-listed Guoxing Property to 30%, becoming the biggest shareholder. Guoxing is now 60% owned by Casin Group. Casin also bought a 25% stake in Singapore-based Great Eastern Life Assurance in 2013.

In light of this, it looks like the move into big-time exchange and settlement management is a move way out of left-field. The fact that the current CEO & President of the CHX, John Kerin, will continue to hold those positions under the new onership and that the rest of the CHX's management team is to remain in place means, in theory, little change. But that is just the theory…

Shengju Lu, speaking for Casin, said. “We have reviewed CHX’s plans to improve market share through new growth initiatives and fully support them. Together, we have a unique opportunity to help develop financial markets in China over the longer term and to bring exciting Chinese growth companies to U.S. investors.”

Casin was also reported as committed to preserving CHX’s current business operations and proprietary trading platform, which has “demonstrated state-of-the-art capacity, speed and system reliability”. But that of course is standard M&A-speak to not “scare the horses” in the run-up to the transition and particularly with regulator’s approval still pending. The SEC certainly does not want a FANYA on its hands.

Some Background

The Chicago Stock Exchange officially became public and opened its offices in 1882. The exchange began to flourish significantly in the late 1880s, with the rate of transactions of stocks and bonds increasing. In 1894, the Chicago Stock Exchange moved its trading floor to the old Chicago Stock Exchange building, located at corner of Washington and LaSalle streets. The old Chicago Stock Exchange building was demolished in 1972.

In 1920, the Chicago Stock Exchange Stock Clearing Corporation was established. Then the Exchnage bulked up in 1949, when the CHX merged with the exchanges of St. Louis, Cleveland and Minneapolis/St. Paul to form the Midwest Stock Exchange. In 1959, the New Orleans Stock Exchange became part of the Midwest Stock Exchange, and in the early 1960s the Midwest Stock Exchange Service Corporation was established to provide centralized accounting for member firms.

In 1993 a rebranding was embarked upon and the exchange changed its name back to the Chicago Stock Exchange. In 2005, the SEC approved a change to a demutualised ownership and now the CHX operates as a direct and wholly owned subsidiary of CHX Holdings, Inc., a Delaware corporation. In 2006, the Exchange announced regulatory and shareholder approval of an investment in CHX by Bank of America Corporation, Bear Stearns (acquired by JP Morgan Chase in 2008), E*TRADE FINANCIAL Corporation, and Goldman, Sachs & Co.

Technology

The Chicago Stock Exchange has long been at the forefront of technological advances to try and rebalance the playing field between itself and the NYSE, the AMEX and the NASDAQ. In 1978 it launched an Intermarket Trading System, a system that allowed orders to be sent from one exchange to another to ensure that customers received the best execution available. In 1982, the CHX launched the MAX system, which allowed CHX to be one of the first stock exchanges to provide fully automated order execution. In 1987, the CHX implemented programs to trade Nasdaq securities.

In 2005, the CHX implemented the Electronic Book trading platform; the predecessor technology of the New Trading Model's Matching System. This Matching System was designed for full electronic trade matching. Publicly traded companies do not need to be listed on the CHX to be traded at CHX and SEC rules allow the CHX to trade stocks listed on other exchanges.

In the near future, CHX anticipates rolling out its new on-demand auction product, CHX SNAP (Sub-second Non-displayed Auction Process), which is designed to facilitate bulk trading of securities on a lit market and to minimize speed and information advantages enjoyed by only a few market participants. The new system received regulatory approval from the SEC in October 2015. CHX SNAP

John Kerin was reported as saying of the Casin deal "..we will have significant additional resources to pursue our new business initiatives, including the launch of our on-demand auction product, CHX|snap, in the spring of 2016”.

What It All Means

It’s probably unfair, but almost inevitable, that FANYA might be mentioned in relationship to such a transaction as this. This is why we have lashed the Chinese authorities for letting the carpetbagging crooks at FANYA besmirch the reputation of other Chinese businesses by being given such free rein to create such damage. Indeed the latest transaction might be the fast-track to redeeming the damaged reputation if Casin can’t ramp up CHX’s operations without any pitfalls. We would expect that there will be a grab for extra business. Some have speculated that this may include adding Chinese listings and we might expect them to pitch for Chinese (of China-related) stocks listed on other US exchanges to make the switch. Beyond that there is the enormous frustrated pile of Chinese savings back in the motherland that could be channeled towards the US equities markets in general. How this might evolve is anyone’s guess, but up until now the Chinese investor in the street has had scant access to foreign markets and so the potential to funnel flow into US stocks for those investors at home tired of the “two booms and busts per annum” cycle in China is enormous in theory. Again.. in theory.

Conclusion

While the temptation is to reel in horror at the idea of the foreigners buying a US institution (Remember the Rockefeller Center!) one can equally find home grown buyers for securities exchanges that have been of less tender mercies than Attila the Hun. We need look no further than the TMX brutalization of the Vancouver and Montreal Stock Exchanges to see that devil one knows is infinitely less desirable (and usually leads to less competition).

Indeed, a wicked thought even passed through our minds that once the Chinese get a grasp of what they have taken on in

Chicago they might indeed turn their attention to the orphan children of the loveless marriage of the TSX with the other Canadian exchanges. While in normal circumstances we would be the first to decry a sell-out to the Chinese frankly they could not make more of a hash out of the TSX-V than the TMX Group did. Investors in junior miners would (and should) probably welcome a change of control of the venture exchange because it could certainly provide a massive jolt of electricity into what is a very forlorn institution. We can only hope!