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IEX Finds Tough Slog To Upend Status Quo

BY ALEXANDER OSIPOVICH

Nearly a year after its launch as a full-fledged exchange that would level the playing field for stock trading, **IEX Group Inc.** is struggling to become more than a niche player.

Part of its dilemma: convincing the high-speed trading firms it once railed against to trade on IEX.

Made famous by Michael Lewis's 2014 book "Flash Boys," IEX hasn't made a dent in the businesses of the **New York Stock Exchange**, **Nasdaq Inc.** and **Bats**, each of which handles roughly one-fifth of U.S. equities volume. In May, it had a market share of 2.2%.

IEX becoming an exchange "has largely been a nonevent," said Bryan Harkins, head of U.S. equities and global FX at **CBOE Holdings Inc.**, which owns Bats.

Around half of U.S. equities volume comes from high-frequency trading or HFT firms, which buy and sell shares in the blink of an eye. Such firms do most of their trading on the major exchanges, which offer incentives to brokers and high-volume traders.

IEX vaulted to fame by crusading against ultrafast traders who use computers to exploit slower investors. When IEX raised funds three years ago, it told backers it planned to reach a market share of more than 8% by 2017. That estimate was based on winning exchange approval in 2015, said an IEX spokesman, who declined to provide updated targets. IEX didn't get approved until June 2016 because opposition from other exchanges and trading firms dragged out the process.

IEX representatives have visited major high-speed trading firms to get them to trade more on IEX. Rob Salman, an IEX salesman, met with Citadel Securities LLC as recently as Friday, two people familiar with the situation said.

When IEX held a launch party at Manhattan's Bowery Hotel in September, it had guests from high-speed traders such as **Citadel Securities, Global Trading Systems LLC, IMC Financial Markets** and **KCG Holdings Inc.**, people familiar with the event said.

But IEX says it won't offer special perks to HFT firms. "We are fair access, and willing to meet with all of our members," a spokesman said.

IEX calls itself the best exchange for investors, citing data showing that trades on IEX have less impact on prices than at other exchanges. Other exchanges don't dispute the

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numbers but say IEX's analysis misses a key point of what an exchange does: providing public data on stock prices.

Before becoming an exchange last year, IEX was a dark pool, where orders to buy and sell stocks aren't publicly broadcast. Today, about one-quarter of IEX's volume is displayed. That means the best posted price for a stock is more likely to be found elsewhere.

In April, IEX's quotes for the most heavily traded stocks matched or beat other exchanges' prices 31% of the time, according to an analysis by advisory firm ViableMkts LLC and data provider May-Street LLC. By comparison, Nasdaq's flagship exchange displayed the best price 89% of the time and NYSE's Arca exchange had it 78% of the time.

IEX argues it shouldn't be judged by its displayed prices. It says it is more important to offer quality executions to long-term investors, a core group that IEX says other exchanges have forgotten.

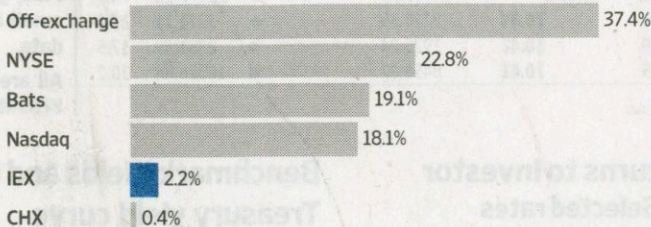
One of the biggest factors limiting IEX's market share is its refusal to pay rebates—the incentives other exchanges pay for orders.

NYSE, Nasdaq and Bats paid more than \$2 billion last year in rebates, according to company filings. Defenders of the

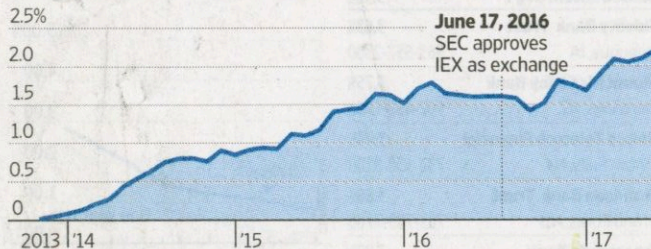
Growing Pains

Three years ago, IEX projected having more than 8% market share by 2017. Now at 2.2%, it calls the earlier estimate outdated.

U.S. equities market share



IEX market share



Note: U.S. equities market share is from May 2017.
Source: Rosenblatt Securities

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practice say it results in more competitive pricing. IEX says it encourages brokers to send orders to the exchange that pays the biggest rebate, rather than the one that is optimal for the customer.

"We're unwilling to pay kickbacks," IEX Chief Executive Officer Brad Katsuyama said.

But that makes it tough to boost volumes. "They're in a bit of a dilemma because they've made not paying rebates a religious issue," said Jamil Nazarali, senior adviser

to the CEO of Citadel Securities, which opposed IEX's exchange application.

IEX, whose backers include venture-capital firm Spark Capital and buy-side firms such as the Capital Group and **Brandes Investment Partners**, is exploring other ways to grow.

One of those is a big bet on corporate listings. If the plan wins approval, companies listed on NYSE or Nasdaq could switch to IEX as early as October.

That would lift IEX's volumes, because the exchange that lists a stock runs its daily opening and closing auctions, which account for a significant chunk of trading. Listing fees also brought more than half a billion dollars last year in revenues to NYSE's parent company, **Intercontinental Exchange Inc.**, and Nasdaq.

At least 10 companies, including some members of the S&P 500, have expressed interest in switching to IEX, The Wall Street Journal reported in November.

Still, IEX faces an uphill battle. "It's a real challenge to build a successful listing operation," said Eric Noll, former CEO of brokerage Convergenx and a member of an IEX outside advisory committee. "It's not going to happen overnight."

And competition is heating up. Rivals have borrowed IEX's ideas, including its best-known feature—the "speed bump", a delay of 350 microseconds imposed on each incoming trade. The delay ensures there isn't a better price on another exchange.

In July, NYSE plans to introduce its own 350-microsecond speed bump to the smallest of its equities exchanges. Mr. Katsuyama dismisses the copycat threat, saying it is a "distraction" from other NYSE practices that harm investors.

This month Bats also introduced an IEX-style pricing model on one of its exchanges.