nvest

2023

AUSTRALIAN RETAIL INVESTMENT TECHNOLOGY REPORT

A new horizon for accessible, affordable, and responsible wealth creation: Alternatives to CHESS

Australian wealth creation is falling behind globally

Ordinary Australians are falling behind global peers when it comes to access to affordable and accessible wealth creation opportunities that help them enhance their financial health and well-being. As a result of legacy technology infrastructure and limitations on what brokers can do, Australians don't have access to functionality and tools available in other markets to enable equitable wealth creation.

Specifically, we find that (despite its strengths), CHESS is a source of many of these limitations. Recent analysis suggests that Millennials and GenX-ers are willing to leave behind legacy CHESS infrastructure in favour of alternative investment models, largely offered by digital-only investment apps. This paper will delve into insights gained from a survey conducted with Australian investors. It's clear from the results that Australians are ready to move forward, into the future of investing that the rest of the world has already adopted.

The data indicates that there is a widespread desire for new technology innovation from organisations with aligned incentives and with strong custodial backing. These new offerings will democratise access to more investment features such as fractional investing, lower fees and lower investment minimums, resulting in cheaper, smarter and new investment opportunities to help Australians build wealth.

> "Australia's fintech sector has seen steady growth and significant progress. However, one area of significant opportunity is investment infrastructure and technology, especially regarding accessibility for retail investors and financial advisors. The current offering is over protective, pricey and is limiting innovation."
>
> Sivan Atad, CEO & Founder | **nVest**

Key insights*

72%

OF UNDER 35s READY TO LEAVE BEHIND CHESS

88%

OF INVESTORS WOULD USE EMBEDDED PLATFORMS

87%

OF UNDER 35s WANT ACCESS TO FRACTIONAL SHARES OR AUTO INVESTMENTS

45%

OF INVESTORS CHOSE THEIR INVESTMENT APP BECAUSE OF LOW INVESTMENT MINIMUMS

53%

OF INVESTORS FIND LOW FEES A KEY PRIORITY

67%

OF UNDER 35s WANT DIVIDEND TRACKING AND TAX REPORTING

nVest

*Based on our survey results & a survey conducted by YouGov in 2022

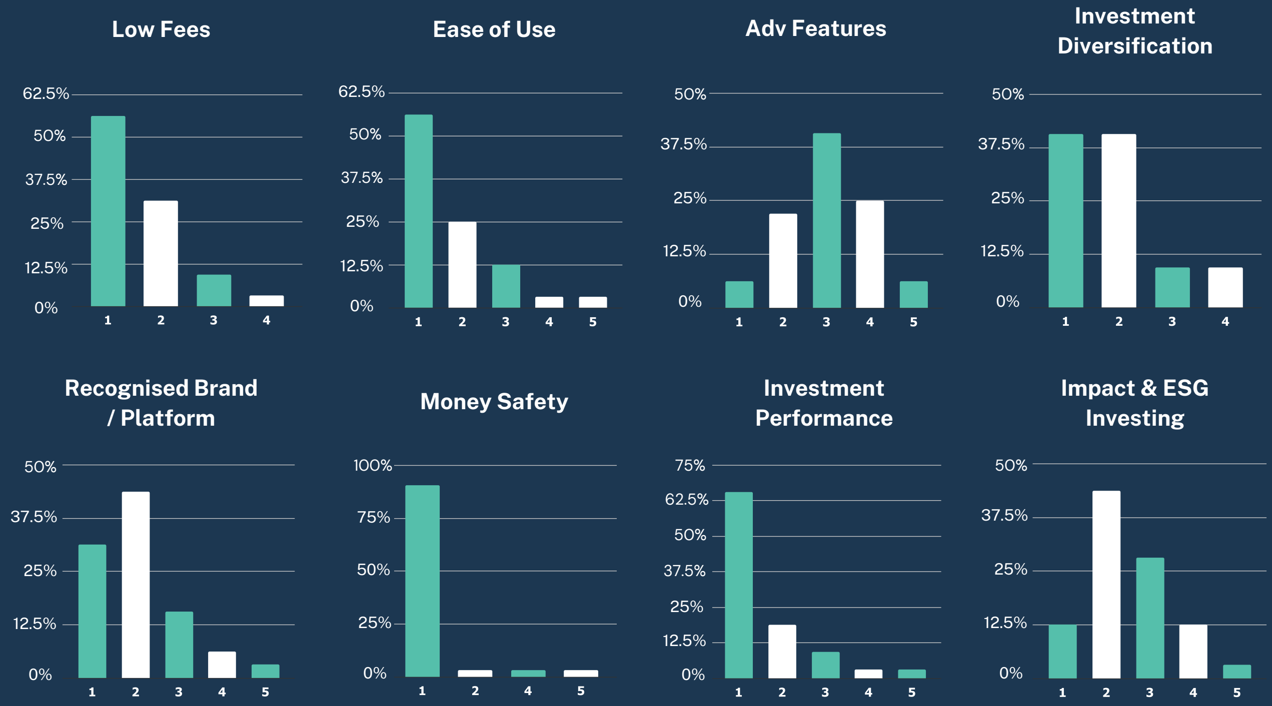
What's important for young investors

nVest

For young Australian investors (aged 18-35), low fees are a priority. Across the board, the 18-35 age group places a high importance on low fees, highlighting a cost-conscious approach to investing. It's additionally clear that ease of use matters for young investors, indicating that user experience is a decisive factor in platform selection.

Factors influencing investment & platform decisions

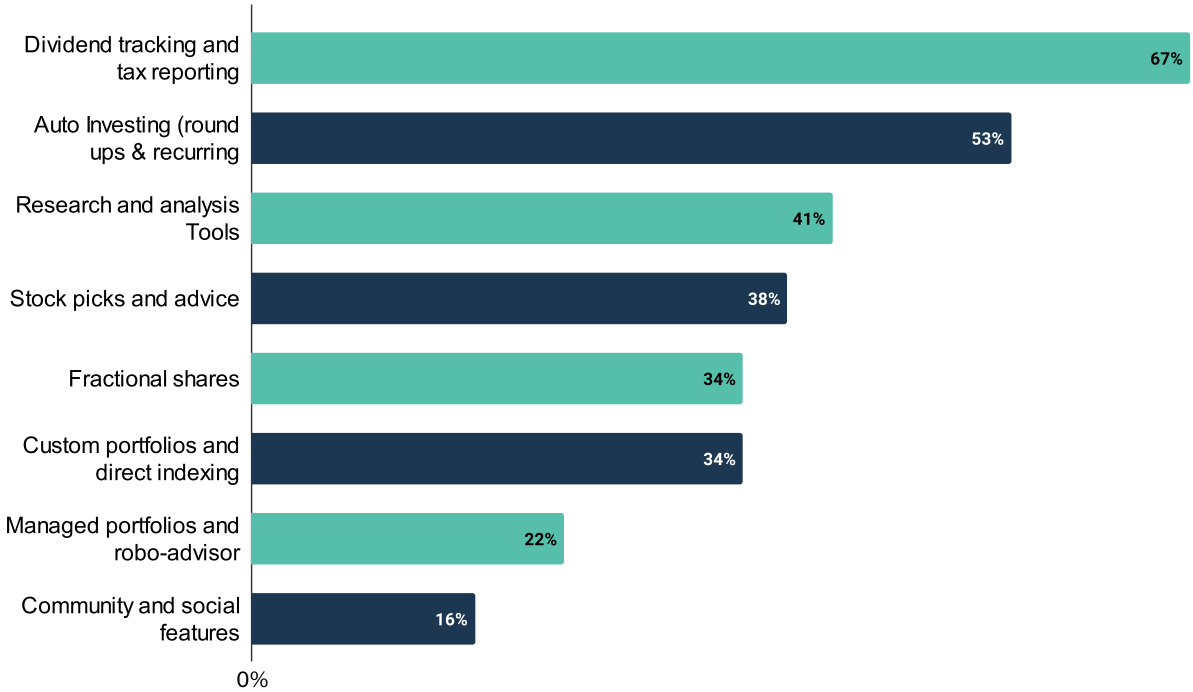
How young (18-35) investors rank key decisions influencing their investments from most important (1) to least important (5)



On top of decisions influencing choosing an investment platform, young investors are seeking modern features built-in their investment apps. Specifically, auto-investing stands out as an important feature, aligning with the greater trend of micro investing, round up & recurring investing features allow investors to create better investment habits. These features go hand in hand with access to fractional investing, which is additionally ranked highly in importance for young investors. These solutions are only viable under non-CHESS based apps due to the high investment minimums of the CHESS system.

Additional platform based features

Additional platform features deemed important by respondents in the 18-35 age range



"Fractional share trading is a hot topic at the moment and more and more firms are looking to offer fractionalisation to increase retail participation. Reduced commissions are also on everyones radar as the cost of trading can be a barrier to entry, especially when you can achieve 5.5% returns in a current account in Australia for no risk.

We are certainly seeing an increase in demand for fractionalisation and constantly considering how we can offer this or partner with brokers / technology providers to enable more retail participation on our trading venues, the London Stock Exchange and Turquoise."

Aanya Madhani, Enterprise Data & Equities Trading
London Stock Exchange Group

What's preventing innovation?

Examining the primary factors that influence individuals to invest through their chosen applications provides valuable insight into existing gaps in the Australian investment market. Many of the essential features identified are presently hindered by a significant obstacle.

Does CHESS meet Australian's needs?

FEATURE	CHESS	CUSTODIAN
Low Fees	NO	YES
Money Safety	YES	YES
Diversification	LIMITED	YES
Dividend Tracking & Tax Reporting	YES	YES
Fractional Investing	NO	YES
Auto Investing	LIMITED	YES
Investment minimums from $1	NO	YES

"Over many years I've seen the investment market evolve, particularly overseas where we see real disruption, innovation and accessibility for next generation investors. In Australia, we're limited by legacy infrastructure, capacity and a legacy market dynamic that is dominated by the traditional broker marketplace model."

Dom Pym | Co-founder **Up**, **Euphemia**, and **Pin Payments**

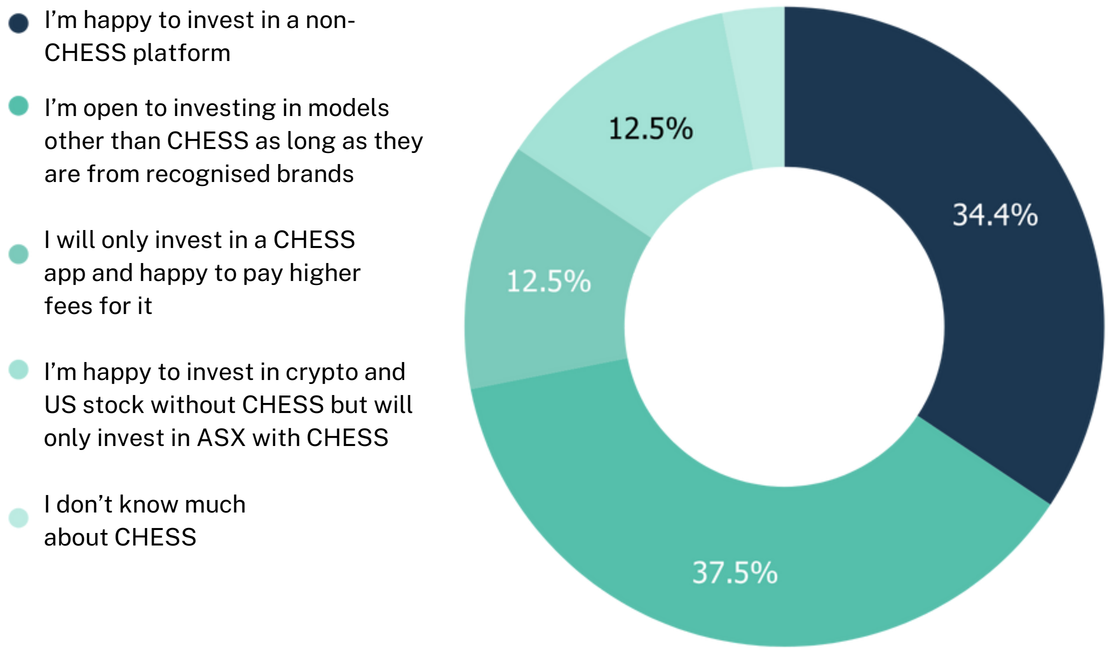
Say hello to the accessible, innovative and cutting-edge custodian model

Luckily, there's a solution, and investors are ready for it.

Recent surveys targeting different age groups in Australia reveal compelling insights. Among younger respondents (aged 18-35), approximately 38% are happy to invest with non-CHESS platforms, and an additional 34% are open to non-CHESS options if offered by recognised brands. Therefore, a total of ~72% of young investors are willing to steer away from CHESS-based platforms to obtain the functionality they want.

CHESS Consensus

How CHESS is viewed in the eyes of 18-35 year old investors



In summary, consumer preferences predominantly focus on features and brand reputation rather than the specific use of the CHESS system. Established brands and custodians are capable of meeting these demands.

It's acknowledged that delivering a unified solution to cater to both high-end and low-end market segments presents a challenge. However, custodians can effectively offer solutions for the low-end market without compromising the quality or performance of existing high-end offerings.

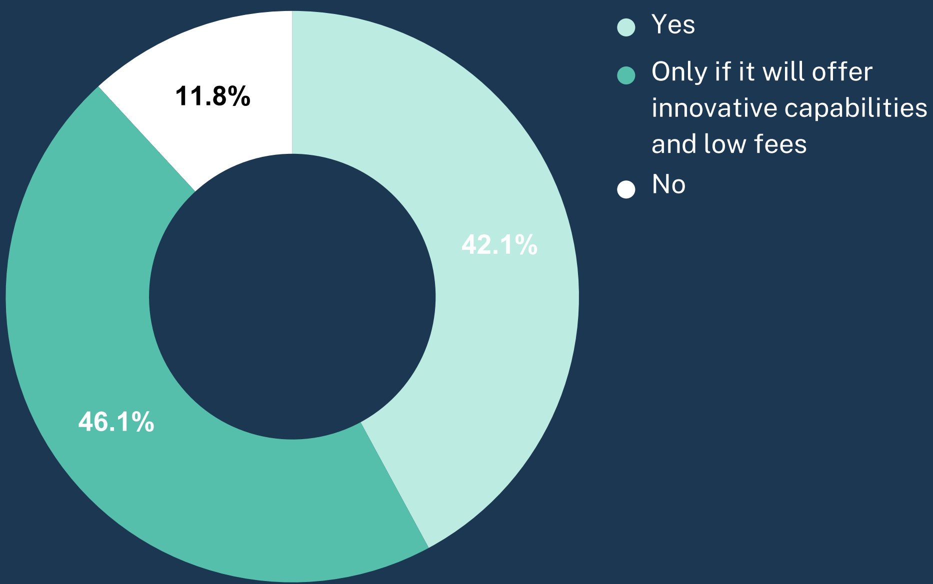
Banks are in the perfect position to capitalise

Given their established brand trust and capabilities, banks are perfectly positioned to bring the custodian offering to their customers. According to the survey, a staggering 88% would use embedded platforms, with 42% of respondents would invest within their banking app, and an additional 46% would do so if the app offered innovative capabilities and low fees.

These findings underscore the readiness and willingness among Australians to embrace custodial models through their trusted banking institutions. This transition would not only enhance the investment landscape but also fortify the relationship between banks and their customers by providing a modern, efficient solution for investment management.

Preferences for embedded investment solutions

Results recorded from all survey respondents ages 18+



"In all of the share investment businesses that we've seen overseas and I've been involved in locally, we've wanted the ability to do fractional investing in real time, with small amounts of capital embedded into different user experiences.

In my experience, the driving force behind some of the great fintechs is user experience and the ability to deliver this service as an API. The modern marketplace demands it. nVest delivers it."

Dom Pym | Co-founder **Up**, **Euphemia**, and **Pin Payments**

A quick comparsion

In the Australian retail investment landscape, the operational characteristics of the CHESS system and the custodial model delineate two distinct methodologies for securities management.

CHESS, or the Clearing House Electronic Subregister System, is known for its direct holding approach, where each investor's securities are associated with a unique Holder Identification Number (HIN). This HIN is transferred as an individual changes from broker to broker and stays unique to them throughout their lifetime of ASX ownership. This system allows for a direct correlation between the investor and their specific holdings.

Contrastingly, the custodial model operates on an aggregated basis, where a custodian, often a major financial institution, holds securities for multiple investors within a collective 'nominee' or omnibus account. Here, individual investors do not possess separate identifiers for each of their securities. Rather, their investments are amalgamated into a larger pool, which is then managed collectively by the custodian.

While this model integrates the financial robustness of large financial institutions, it is not inherently safer or riskier than CHESS. Both systems offer different forms of security: CHESS through direct individual ownership, and the custodial model through the backing and oversight of established financial entities. Thus, the key distinction lies in the nature of asset registration and management, with CHESS emphasising individuality and direct ownership, and the custodial model focusing on collective management under the security umbrella of established custodians.

Global dominance

In the United States, the custodial model has empowered a broader range of people to participate in the investment market. Online brokerage platforms like SoFi,[1] which operate on custodial models, have played a vital role in this. They offer zero-commission trades and a user-friendly interface, attracting millennials and Gen Z investors who may have found traditional brokerages intimidating or costly.

The flexibility of the custodial model has been a boon for financial innovation. Robo-advisors like Wealthfront[2] and Betterment[3] have flourished in this environment, offering automated investment services at a fraction of the cost of traditional financial advisors. Similarly, the model's scalability allows for fractional investing, which means that for the first time, retail investors can invest in high-value stocks like Amazon or Google for as little as $1.

The custodial model's operational efficiency translates into lower costs for the end-user. For instance, the use of omnibus accounts, where the securities of many investors are pooled into one account, significantly reduces transaction fees. This cost advantage has been one of the driving factors behind the model's success in markets where it operates.

How retail investors own & trade their shares

Region	Ownership Model
Australia	Primarily Direct (CHESS)
New Zealand	Majority transitioned to custodian*
USA	Custodian
Europe	Custodian
Asia	Custodian

*With rapid adoption of Sharesies in NZ, the first custodian based online brokerage, majority of retail investors are moving away from direct ownership

1 FRACTIONAL SHARES | SOFI
2 INVEST FOR THE LONG TERM ON YOUR TERMS | WEALTHFRONT
3 AUTOMATED INVESTING | START SAVING BETTER.

Already a part of the Australian financial landscape

Shares

While CHESS remains a venerable institution for Australian investments, it's worth noting that when it comes to U.S. equities, Australians are increasingly opting for custodial systems offered by broker apps such as Stake[4] and Commsec, and for local stocks, they're turning to platforms like Superhero[5] and Sharesies.

The key distinction here is in the infrastructure; U.S. stocks are benefiting from custodian and fractionalisation services provided by B2B SaaS fintechs as part of their infrastructure, whereas local platforms like Superhero and Sharesies have developed these custodian trading solutions in-house. This self-built approach means these platforms incur substantial costs in the development and maintenance of their systems, impacting their profit margins and business models. In contrast, overseas, the B2B fintech solutions allow consumer-facing (B2C) brokerages to concentrate on enhancing customer engagement and delivering additional value without the hefty investment in backend systems.

Managed funds

Managed Investment Scheme (MIS) based platforms, including Vanguard Personal,[6] Raiz,[7] and Spaceship, are expanding the scope of retail investment in Australia by offering opportunities to invest both locally and overseas. While Vanguard Personal is not a micro-investment app per se, it aligns with the broader trend of facilitating low-minimum investments under a managed fund structure, similar to platforms that cater to micro-investing. This development is part of a larger movement, where YouGov[8] research indicates that half of the users of investment apps began their journey in the last two years, reflecting a growing interest in digital investment channels.

These platforms, falling under the MIS category, enable Australians to invest incrementally with low minimums. However, it's crucial to recognise that such funds often provide limited investment choices and can carry higher levels of complexity and costs due to their intricate legal setups. They also lack immediate access to live market prices, with pricing determined at the end of the day through batch processing by the fund manager. While they fulfill a specific need for low-barrier fractional capabilities, they do not present a comparable alternative to the more diverse and cost-effective fractional trading offerings available internationally.

4 DO I OWN MY SHARES? | STAKE SUPPORT
5 HOW ARE MY SHARES PROTECTED BY SUPERHERO?
6 UNDERSTANDING THE ROLE OF CUSTODIANS | VANGUARD AUSTRALIA PERSONAL INVESTOR
7 WHAT IS A CUSTODIAN AND WHAT DO THEY MEAN FOR RAIZ USERS? - RAIZ INVEST
8 MICRO-INVESTING IN AUSTRALIA: WHAT'S DRIVING TAKE-UP & HOW DO MAJOR INVESTMENT PLATFORMS COMPARE? | YOUGOV

> “Vanguard Australia support advancements that make the investment experience easier and more accessible for clients to achieve the long-term goals.
>
> We believe a custodian model offers considerable benefits to investors with the pooling of assets creating efficiencies of scale from an operational and costs standpoint.
>
> We currently offer fractional investing across our managed fund range through our Personal Investor platform. We believe that fractional ETF investing may be of particular benefit to investors who are building their investment portfolio by investing small amounts regularly.”
>
> **Vanguard Australia**

As explored earlier, our survey findings align well with this trend. A significant portion of younger investors prioritise low fees and the ability to invest smaller amounts. For example, 55% of young investors find low fees essential, while 34% of them value the availability of fractional shares, which allows them to diversify their portfolios even on a modest budget. These preferences mirror YouGov's data, where 45% of users cited the ability to invest smaller amounts as a key factor, and 35% highlighted the importance of low costs.

It's telling that investors are willing to sidestep CHESS when it means access to their favourite overseas companies or when utilising the growing market of micro investment platforms

>50%	45%	35%
Joined in the last 2 years	**Consider apps that allow small investment amounts important**	**Highlight the importance of low costs**

YouGov, 2022

Superannuation

Then there are Super Funds — integral to Australia's retirement planning — which primarily operate on a custodial basis. Super funds operate under a mutual funds structure which, for those with a mandate to invest in equities, register the equity holdings in the super nominee name rather than the individual super fund member's name.

There's a certain irony in the fact that the industry worth $3.5T designed to provide financial security in retirement doesn't insist on the CHESS model, and yet, Superannuation firms are some of the most tightly regulated and secure investment vehicles in Australia.

Cryptocurrency

The rise of cryptocurrency investment, facilitated through various platforms that operate on a custodial model, indicates that when it comes to high-risk, high-reward assets, Australians are willing to eschew the CHESS system entirely. The crypto market operates 24/7, offers instant transactions, and is global from the get-go — all things that the rigid, dated CHESS system could never provide.

CHESS, a relic obstructing innovation

So why does Australia cling to CHESS like a relic of the past?

One could argue that the current brokers, platforms and market participants have a vested interest in pumping out fear, clouding the perception of alternatives. Yet, as this report points out, the custodial model has not only proved its mettle overseas but is also stealthily dominating various asset classes within Australia itself.

Sharesies

Closer to home, the rapid adoption of Sharesies in New Zealand, with proprietary technology offered exclusively to their retail customers, highlights the potential for innovative custodian and fractional investment models. Within five years, Sharesies attracted half a million users or almost 10% of the country's population with $2 billion invested,[9] demonstrating a strong appetite for user-friendly and accessible investment platforms. This case indicates that when well-executed, retail investors significantly lean towards innovative custodian fractional options.

The success of the custodian model in diverse investment areas signals that Australia is well-prepared for a financial landscape transformation. This model not only enables diversification and access to premium blue-chips but also fosters a more competitive retail investor landscape with reduced fees. Additionally, it enhances market liquidity by welcoming smaller trades. Given its proven safety, strength, and long-term viability, the custodian model should instill ample confidence for Australia to transition towards this innovative framework.

9 HOW SHARESIES TOOK OVER NEW ZEALAND'S ONLINE INVESTING MARKET | THE SPINOFF

This begs the question, why is Australia holding on to it?

A costly lesson: What led to the $250 million failure

The failure to replace CHESS has resulted in a costly $250 million setback for the ASX.

Despite technological advancements, efforts to modernise the system have been stymied by vested interests, keeping Australia lagging in the global investment arena. While reports from ASIC, EY and Accenture[10], state that technical issues played a significant role, the other obstacles include the unwillingness to disrupt the status quo, which hampers innovation and complicates the trading landscape.[11]

There has been significant resistance from existing market players who stand to lose from an overhaul. Australia's clinging to CHESS has been less about safeguarding financial systems, and more about stifling financial innovation.

As global finance elites like Charles Schwab[12] and Fidelity[13] explore the realms of financial services, there's potential for a significant shift in Australia's investment landscape.

The recent initiatives by fintech firms Monzo[14] and Revolut[15] in the UK, who have launched intuitive, app-based investment platforms, exemplify the type of innovation that could flourish in a more deregulated financial market in Australia.

chip monzo

Robinhood Revolut

10 ASX CHESS REPLACEMENT APPLICATION DELIVERY REVIEW | ACCENTURE 2022
11 ASX CEO DOMINIC STEVENS LEAVES $250M IN CHESS-BLOCKCHAIN UNFINISHED BUSINESS
12 CHARLES SCHWAB TO OFFER FRACTIONAL STOCK TRADING TO LURE YOUNG CLIENTS
13 STOCKS BY THE SLICE | FRACTIONAL SHARES WITH DOLLAR BASED INVESTING | FIDELITY
14 MONZO INVESTMENTS | LEAVE THE HARD WORK TO US
15 INVESTING FOR BEGINNERS | HOW TO START INVESTING IN STOCKS | REVOLUT

It's Australia's turn

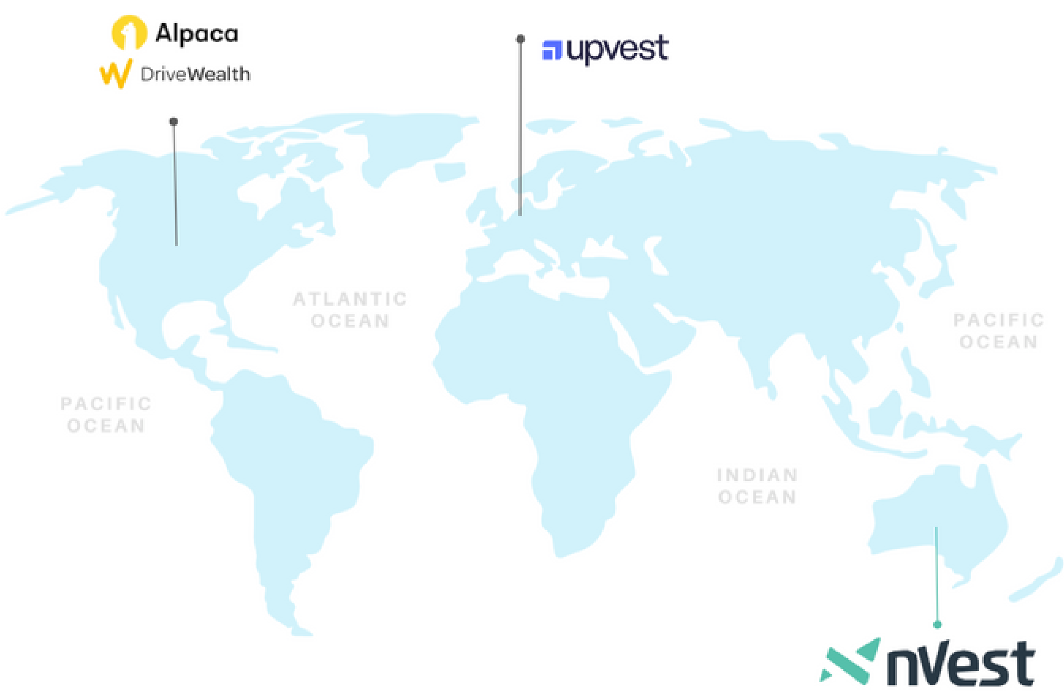
Incentives aside, although the big four local banking giants haven't yet ventured into the custodial investment market, their established infrastructure and customer trust could play a pivotal role should they decide to pivot in this direction in the future.

By reducing barriers to entry and making investment opportunities more accessible to a wider demographic, these fintech companies are setting a precedent for financial innovation that could drive a more inclusive and modern financial ecosystem in Australia.

The opportunity

Players like nVest and international counterparts such as Upvest and DriveWealth are emblematic of how the transition towards a custodian model can be executed without requiring extensive changes to the existing infrastructure. nVest, an Australian platform, utilises a fractional registry maintained within its platform, employing a custodial model to safeguard customer holdings.

This arrangement empowers nVest's clients to confidently offer fractional investment services to their end-users, which addresses a significant barrier in the investment realm.



Final takeaways

In the fast-evolving landscape of financial markets, Australia has the unique opportunity to leapfrog into the future with the custodial investment model. Which can not only promise a democratisation of investing but also lower fees and greater control for investors. nVest is at the forefront of this revolution, capitalising on these progressive models to offer next-generation solutions.

With plans to unveil a slew of innovative offerings in the coming year, nVest aims to pave the way for a more accessible, efficient, and inclusive Australian financial market. The potential for transformation is immense, contingent only on the alignment of regulatory frameworks that foster, rather than hinder, innovation.

"nVest is receiving substantial support from the fintech community and established players to drive innovation in this field.

As the first B2B player in Australia to unlock omnibus fractional trading for Australian Stocks, our goal is to assist our partners in launching a minimum of 10 new investment products in the coming year. We're also collaborating with regulators and infrastructure providers to streamline access and implementation.

The technology we're developing has the potential to benefit other countries that are still catching up, enabling them to modernise their offerings and attract investors back to their markets."

Sivan Atad, CEO & Founder | **nVest**

Contact

Sivan Atad
CEO & Founder nVest
sivan@nvest.au

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Produced by Jack Payne & Sivan Atad