Edited Transcript of ASX FY 2010 Media Briefing

19 August 2010

George Liondis – Australian Financial Review:
Obviously one of the big things on the horizon for the ASX is the introduction of stock exchanges competing with the ASX. What is the ASX's level of readiness for that competition and how much of an impact do you think it will have on the ASX's business?

Robert Elstone, Managing Director & CEO, ASX Ltd:
On the readiness front I think that has got a number of dimensions to it George. Clearly many of the points I have touched on - in relation to technology change, both of our core technology platforms and introduction of new order type functionality and unbundling of our fee arrangements - are all measures of our state of readiness for competition. So I am quite confident that we will be ready, and well placed, to compete fairly as and when the competition starts.

If your question was a codified way of asking me when will it start, we don't know. I think the next most important step is the fairly imminent release of the market integrity rules, because that is really the architecture of the new system. We expect that to be a few weeks away yet, and that will be subject to a robust consultation process with a wide stakeholder group.

So I think we have done as much as we possibly could have given that we are still in a state of ignorance as to how granular the market integrity rules will be. That's why Peter [Hiom] made reference, in the analysts briefing this morning, that we are likely to continue to roll out, once we have upgraded the technology, version responses which will provide additional functionality. So I think we will stay as ready as we can be today based on what we know, and we will continue to respond as more of the regulatory framework becomes visible to us and to everybody else. I am not sure it's a question I can really respond to intelligently to beyond that.

George Liondis – Australian Financial Review:
What will be the impact of competition on the ASX's business?

Robert Elstone, Managing Director & CEO, ASX Ltd:
As a business, well it depends on assumptions you make about how successful the competitors will be in terms of market share. We make internal estimates of that based upon what has happened in other marketplaces, but certainly the analyst community has picked up on the fact that our cash equities market trade execution revenue is about 10% of the entire revenue of the ASX Group of Companies. The fact that we have already made one substantive pricing move, by almost halving our headline trade execution fee in equities points, to the fact that we have in part responded to the prospect to competition in the pricing area as well as in the technology and functionality area.

If your question again is do I think it will be a mortal blow, and is this the beginning of the end of ASX, no I don't believe that for a moment. But how successful competitors are will be a function of, again, the regulatory architecture and I think that is really all I can say on that topic. I am not trying to dodge your question but we only have some of the information available to us and we could only prepare in those areas where we can make informed guesses. We are not going to make informed guesses about what the market integrity rules will actually look like until they are published.

Ky Chow - Sky Business News:
What do you see as the potential impact of high frequency trading, if that comes to Australia, in particular for the ASX?

Robert Elstone, Managing Director & CEO, ASX Ltd:
I commented this morning that I don't think high frequency trading, or that community, is inherently evil or inherently good. It just is what it is. The point I was making this morning, and I will restate to you, is that I think the challenge for regulators and policy makers as they think about the evolution of the regulatory framework and the market structure that seeks to attract more high frequency trading, is that the regulatory framework needs to be careful not to lose sight of what function the market is here to perform. Because whilst the high frequency trading community can bring additional liquidity you need to be very careful about your definition of liquidity. There is no doubt as and when high frequency traders come on a greater scale, we will see a lot more orders coming into the market, but orders coming into the market does not equate to liquidity. We may see some narrowing of spreads, but the $64,000 question is: Is that a permanent narrowing or is it transitory? I think the challenge for policy markers and the regulators is: How do we ensure that the primary purpose of the market - which is to ensure efficient capital allocation for both listed issuers of capital and traditional long term investors including retail investors - how do we ensure that their interests, which is why the market is here in the first place, are not prejudiced or made second order issues simply to accommodate appeal to high frequency traders.

There is no doubt that high frequency traders have the potential to add liquidity to the market. The question mark is how sustainable is that liquidity. If you look at the events overnight on May 6, the so called flash crash in the US, I describe them as fair weather friends. I think they are very good at bringing liquidity when there's lots of liquidity around. They do introduce complexity into the market structure and the evidence coming out of the flash crash is that it is very, very hard for policy makers and regulators to stay ahead of the game when the pace of technological innovation coming out of high frequency trading community is as fast paced as it is. I don't want to sound too serious in my tone of response to your question, but it's a really good question and it's a very serious question for policy makers and regulators to come to grips with.

Ky Chow - Sky Business News:
But high frequency trading in the Australian market is inevitable, because you have already started preparing, right?

Robert Elstone, Managing Director & CEO, ASX Ltd:
It is an inevitability because a higher and ever higher percentage of overall trading volumes through most of the major developed exchanges are being sourced from the high frequency trading community. So again, the challenge for the policy architects is: Do you bias all the rules of the market structure to the interests of the high frequency traders? I think you can tell from my tone I don't think that's particularly smart or responsible from a

public policy perspective. The challenge is: How do you get the balance between preserving the interests of the traditional issuers of capital and longer term investors, including retail investors? To me they are the two stakeholder groups whose interests should prevail. If it's feasible for their interests to dominate, and yet at the same time to accommodate some of the benefits of additional liquidity that high frequency trading can bring, then that's the nature of the policy challenge that I think the government has in front of it.

Andrew Robertson - ABC:
I am just wondering how would you characterise trading conditions on the ASX at the moment and how would you characterise today's results?

Robert Elstone, Managing Director & CEO, ASX Ltd:
As I indicated, for the first six weeks of this current financial year - so since 30 June up to today - I think our cash equities market volumes and values are broadly in line with all the other major developed incumbent exchanges around the world. It's been, not quiet or lacklustre, but there has certainly been an absence of growth in those trading volumes and values and that is a very consistent trend. I think the externalities I have quoted largely explain that so I wouldn't describe them as either poor or particularly buoyant.

In terms of our result I think it's a very strong result albeit with a large transposition of the source of income, because clearly net interest income has dropped. But I think the market should like the result because at the EBITA line, which is the overall operating cash flow driver of the business, that's up virtually $50 million year on year and I think that is a robust financial performance. I described our operational performance as robust in terms of availability of our systems, and I think having listened to the kind of busy year that Eric [Mayne's] had, the supervisory and compliance side has also been active. I think the Exchange is in remarkably good shape, both generally and in terms of Ky Chow's question, in terms of its state of readiness for an evolving market structure over the next twelve months or so.

Andrew Robertson - ABC:
A second question, I noticed the revenue was up 9% but net profit after tax was only up 5%, what do you put that down to?

Robert Elstone, Managing Director & CEO, ASX Ltd:
That's almost all explainable to what I said a minute or so ago, that net interest income was quite a way down on the prior year and that's largely because the prior year had this freak year of the global financial crisis where our risk margin collateral that we carry through our clearing house subsidiaries went to an all time high. If we look back to that, [Bear] Sterns, Lehmann Brothers, AIG, in the 4th quarter of '08, we carried record levels of risk margins. The credit spreads that we were earning on those risk margins blew-out tremendously, whereas the net interest income line in the year we have just finished has gone back to its normal level. Thankfully that has been more than compensated for, so the reason you are seeing the net income - the different growth rate between headline revenue and net income growth - is purely because of that source of earnings disposition. But I would far rather have higher growth in EBITA than higher growth in net interest income, because it is more likely to be sustainable and less fickle.

George Liondis – Australian Financial Review:
Robert, you have touched on the May 6 event in the US a few times there. I wonder if you might comment on what you think the risks are for the integrity of the market here by allowing multiple market operators to operate in

Australia, firstly. And then there is a supplementary question, in your annual report today you talked about concerns about an ambitious timetable for introducing some of these changes. Everyone at the moment seems to be under the impression that we will see alternative stock exchanges in Australia by early next year. Is that too ambitious a timetable?

Robert Elstone, Managing Director & CEO, ASX Ltd:
They are two good questions and they are actually linked questions because if you read my words carefully - and it sounds as though you have from the way you framed your question - I think on the first part of really the same question, on the risk to market integrity, my written commentary that we released this morning said there is no doubt that if from a policy perspective you want to introduce competition into the market services space, you need to introduce complexity and with complexity goes both cost and risk. Now I need to be careful when I say that because I will be accused of saying don't do it or it's too dangerous. I don't believe that for a moment, so my written words said that what is absolutely important is that the benefits of competition, and they are there to be got, do not come at a cost of market integrity. What I meant by that is that none of the policy challenges raised by the prospect of evolving to a multi-market structure are insolvable problems. None of them are insolvable. But you don't solve them by pretending they are not there, or trying to solve them so quickly that you end up with serious unintended consequences. And I think my reference this morning - and in my response to the gentleman from Sky Business News' question - was I think what's troubling about the flash crash of May 6 and those events is that the incident report, the root cause is still not known and the fact that it is highly likely that market structure either caused the problem or contributed to exaggerating the scale of the problem is a serious risk.

Australia has the huge advantage of being late into this space. Therefore it can learn from the mistakes of others who have simply opened up their markets to competition on a very simple theory that competition is good. And it probably is good, but it's only good if all the checks and balances are in place to make sure that unintended consequences are avoided. So this morning, in another place, I talked about the need for universality of market rules and that rules based competition, or regulatory arbitrage as people would call it, could open up serious systemic risks for the quality of the price discovery process that couldn't possibly be in the interests of long term issuers of capital.

So my comment really is, with all due respect to the license aspirants, I don't see how a timetable can be set for them to start quite separate from a timetable for a robust review and checking process. They are simply incompatible statements because the minute you set a timetable for someone to be granted or have a license become operable, by definition you are setting a timetable for the testing process for the thoroughness of review of the regulatory policy framework; a timetable for the technological state of readiness of market participants. And to me, in a genuine public policy sense, those other issues are more important. So my comment, just to restate it, was not designed to be anti-competitive and it would be wrong to portray it as such. I don't think any of the policy challenges the introduction of competition for market services introduces are insurmountable. They are all solvable, but we won't solve them by pretending they don't exist and we won't solve them by fast tracking solutions that may not be actual solutions. And really that's a long winded way of saying from a government and regulatory point of view: get it right, don't get it early.

Ky Chow - Sky Business News:
Some of the analysts seem to be impressed by how some of the cost cutting has helped with the bottom line. Now you have some aggressive competitors coming here looking to spend up big, while at the same time you are trying to control your costs. Is there an incompatibility; is there a tension there at all?

Robert Elstone, Managing Director & CEO, ASX Ltd:
I think probably the stress point is more likely to be around our capital expenditure profile and the crowding-out effect of our ability to implement projects quickly, rather than the cost base per se. I think we have established, certainly on my watch, a demonstrable track record that we can control our costs. I think the pressure points are far more likely to be on the rate at which we can practically expend capital, and the rate at which we can deliver projects to make sure our competitive responses are timely and appropriately tested. I am not troubled in any of those directions, but I am far more preoccupied by our ability to actually deliver projects on time and on budget than I am by any latent likelihood that our cost base is going to blow-out seriously. I don't think that is likely in the near term at least.

Ky Chow - Sky Business News:
Are there any projects in particular that you see?

Robert Elstone, Managing Director & CEO, ASX Ltd:
Well this year is a good example. We are changing out our core matching engine for cash equities and we are changing out our core matching engine for futures and options. We will be introducing smart order routing and we will be redefining and introducing new data services. So we have a lot of fruit in our bowl this year to deliver, and it is that that preoccupies me far more than are the costs likely to blow out over the next 12 months. I don't think that's very likely and history would tend to suggest that it's not likely either. Andrew has one more question?

Andrew Robertson – ABC:
Just on today's numbers - it looks like about 44 cents of every dollar that comes in on the revenue line goes straight to the bottom line. Can you protect that in a competitive environment?

Robert Elstone, Managing Director & CEO, ASX Ltd:
Well we will certainly be doing our level best, Andrew, to do it. But in part, that's a function of the operating leverage in the business. This is essentially a capital intensive fixed cost business that tends to suggest that your earnings cycle will go up and down with activity levels. But look, there is no doubt that our margins will be under pressure as and when competition starts, and some of the moves we have already made under our own head of steam - like reducing the headline trade execution fee - have already started. We don't need competition to start to begin to respond to it, and that's exactly what we have done. I am not really in the sort of margin forecasting business, but clearly they will come under pressure as and when competition does start.

If there's no other questions from the room I will flip to the telephone and invite telephone audience members to give us their questions.

Patrick Durkin - Australian Financial Review:
Oh good afternoon. The question to either or both of you is: Can you explain or justify why the ASX is entitled to dip into the National Guarantee Fund to subsidise the costs for paying for ASIC's supervisory role, especially given from what I have seen today you have made a record $3.3 million in fines but spent less than $1 million in education and training for the industry? And secondly to that: How long will you be required to make this subsidised payment of $3.14 million to help pay for ASIC's new role? Is that an indefinite payment?

Robert Elstone, Managing Director & CEO, ASX Ltd:

I will respond on the $3.14 million first because it's a matter of public record, with the regulation being passed, that that was the sum set for the current financial year post the transfer. I think you can take from public reading of the regulation that that will be, not necessarily the number, but the levy will be a permanent impost. On the fines versus education I will let Eric [Mayne] respond to that one.

Eric Mayne, outgoing Chief Supervision Officer, ASXMS:
The first point I will make in relation to the comparison you do with the $3.3 million and the $1 million in terms of as being on the fines. What we do in relation with the education research fund is that we spend the amount of money that was recovered in fines from the preceding year, and we only ever dip into the pool of funds that come into the fines in the current year if we feel that there are worthwhile programs to do that, and before we do that we get board approval. Having said that, we did this year dip into the $3.3 million pool that was building up over the course of the year because we had some worthwhile programs. The $3.3 million is the gross amount. Out of that we take out the costs of running the Tribunal, and I think roughly it's about $600,000 that might have been incurred during the course of the last 12 months, and so therefore there's probably at least about $2 million sitting in the fund that is available going forward.

We put before the board, programs that we consider would be appropriate for education over the course of the next year, and if need be - depending on the amount left in the fund - we will continue to use that to carry out those sorts of activities and other activities after deducting any costs associated with our enforcement function. You should bear in mind also, Patrick, is that the level of fines for the $3.3 million were largely imposed in relation to the more serious breaches and they were ones around market manipulation. Going forward, that function has been taken over by ASIC. So that there won't be the same level or size of fines in years to come that we have been able to have the benefit from, for the purposes of education, that the tribunal has imposed.

Patrick Durkin - Australian Financial Review:
I don't think you answered the question about the National Guarantee Fund.

Robert Elstone, Managing Director & CEO, ASX Ltd:
No I am just coming on to answer that one. There are three costs that have been incurred. There have been severance costs or dislocation costs, there are establishment costs which would fall to ASIC not to ASX and there is a permanent cost differential associated with ASIC conducting the function which wasn't incurred by ASX. So there are three categories of costs. They are not hugely material in nature and they are coming out of excess monies in the fidelity funds, not monies that would otherwise be available for investor protection. I think that answers your question.

Enda Curran - Dow Jones:
I am just wondering if you have a date from the AOFM of when you might start listing the government securities. Secondly, given that both sides of politics here - like the rest of the world - are talking about reducing issuance, will that impact whatever plans you have for that.

Robert Elstone, Managing Director & CEO, ASX Ltd:
I wish we did have a date but it's not our decision to make. It will end up eventually becoming a Treasury and Treasurer decision, for whoever wins government on Saturday. It's not inevitable that the decision will even ever be made. But I think the various stakeholders around markets generally are almost universally of the view that a retail government securities market is one of the fundamental underpinnings of getting some traction in any

corporate bond market aspiration. So we would hope - once the dust has settled from the election outcome - that the various stakeholders will continue to urge whoever the Treasurer happens to be, to make this decision. I wouldn't guess whether it's weeks, months or even years away.

The second part of your question, I think prior to the GFC and the debt stimulus, the current Labor government had already made a commitment to expand the stock of CGS on issue from 50 billion to 75 billion, simply because it was in the interest of the market to ensure that there is ongoing liquidity. So even if the Liberal/Coalition were to win office and begin the process of trying to restore to the fiscal position of the country to a neutral net debt position, it is highly likely that at least 75 billion of bonds will stay on issue, and that would be ample stock to support retail CGS issuance if and when the then Treasurer ever wanted to make the decision.

There are no further questions from the phones but there is one from the floor.

George Liondis – Australian Financial Review:
I wonder what the rationale is for the enhanced disclosure requirements for the resource companies?

Robert Elstone, Managing Director & CEO, ASX Ltd:
I think the rationale is simply that if you look at the countries around the world with strong extractive mining or energy sectors - and so the obvious ones are us, Brazil, Canada, South Africa - just as Eric [Mayne's] talked about the Corporate Governance Council, I think all of these countries are at various stages of contemporisation of their equivalents of what we call our JORC code which is embedded in our listing rules.

It has been quite a few years since, I think, the contemporisation process. We felt it was a little bit overdue and we didn't want to fall behind the disclosure trends. We think it's important that Australia stays at the forefront of continuous disclosure generally, but with the mining and extractive sectors being such a large part of our index we felt it was overdue.

The second reason is that with an emerging oil and gas and geo-thermal scaling up, I think the lessons that already are embedded in the existing version of the JORC code, even before it is contemporised, have huge application to use those standards into other sectors of the energy market.

So it was really an opportunity to apply both a contemporisation of the mining sector to apply that to the oil and gas and geo-thermal sectors, so that we had a common a set of principles and standards across all three areas of the energy market over the next year or two.

Inaudible, off-mike question regarding disclosure:

Robert Elstone, Managing Director & CEO, ASX Ltd:
Do you want to comment Eric [Mayne]?

Eric Mayne, outgoing Chief Supervision Officer, ASXMS:
Yes. You will probably get more qualitative disclosure, and looking at resources, and what the level of resources are maybe likely to be around, that's where one of the areas of focus will be. We are at the process of working together with JORC to put out - probably by the end of this calendar year - an issues paper about what are some of the areas of potential improvement, or areas of additional disclosure, that could be put into place, and getting

feedback from stakeholders within Australia. We would also probably get some feedback from other organisations around the world.

Once we get the feedback on that issues paper, we would then probably put out a formal consultation document with some draft changes to it. At the moment ASX is working closely with JORC. We will and have had some discussions and feedback from ASIC who has an interest in this space as well.

Transcript ends