2013 ANNUAL STOCKBROKERS CONFERENCE

ADDRESS BY ASX MANAGING DIRECTOR AND CEO – ELMER FUNKE KUPPER

30 May 2013

Check against delivery

Building on the strengths of our financial markets

Thank you for inviting me to speak at your conference for the second consecutive year.

Let me start by thanking you for your business. The last year has not been easy. Fortunately, recent months have seen some recovery in trading volumes and we hope that you have benefited from the improvement.

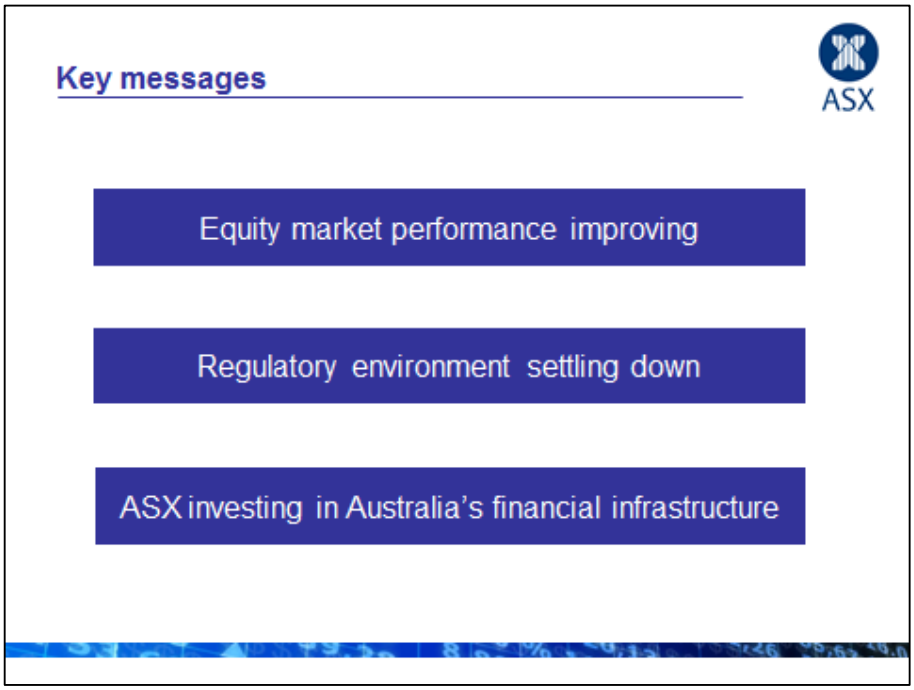
I have now been at the ASX for 20 months. A lot has happened in that time. There has been much industry discussion about market fragmentation, regulatory change and new investments in post-trade services. All have been important conversations and ASX has participated in all of them.

In doing this we try not to make assumptions. We get the facts. We do the analysis to see how changes affect different participants. We explore all of the consequences - including unintended ones - and think
about what is best for Australia's financial markets and for ASX and its stakeholders. In doing our homework we do not look at Australia as an island. Our mission is to be competitive in a global environment and position us for success in the Asian Century.

Overall, I think our regulators have done a good job over the last 12 months. Their decisions on market structure have left us in a better position than many other western markets. I also believe they've paid attention to the impact of change on the end users of our financial systems – companies and investors. This acknowledges the fundamental reasons our market exists – they being capital formation, long-term investment and risk transfer. Everything we do as an industry has to support these reasons for being, and improve our position in the world.

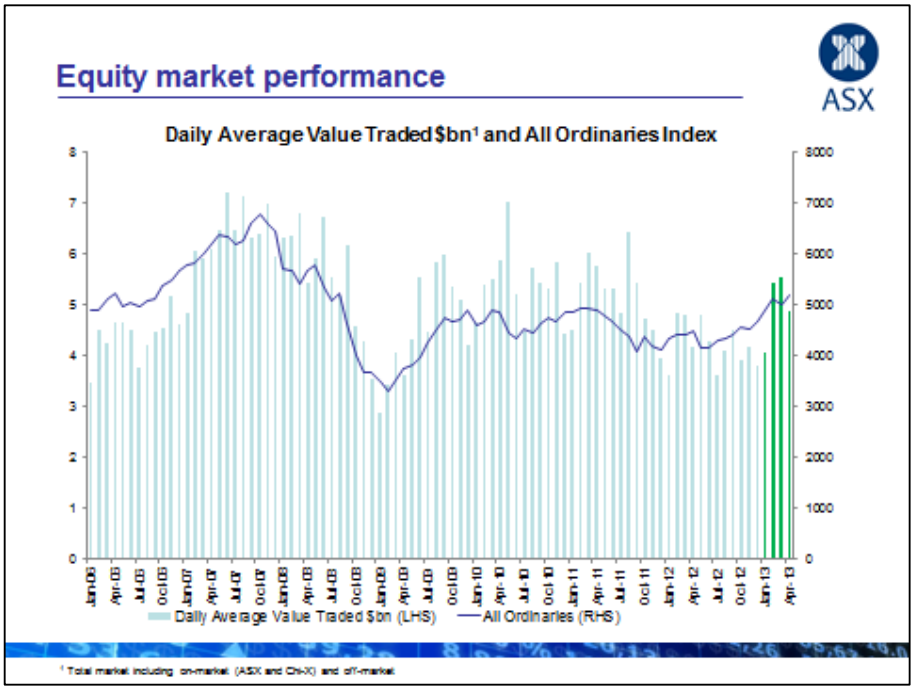
This is why I have been so vocal about fragmentation. Despite the way some may try to justify the benefits of fragmentation, to my knowledge no new investors have been attracted here because of it and it will not assist in realising our ambition to be a financial centre.

Over the last two years most of our discussions have been inward-looking. They were focused on how we divide a relatively small pie of revenues between local players. This is largely wasted energy in a globally competitive world. We now need to focus externally and make decisions that position Australia to be globally relevant. This is what the key markets around us are doing, including Hong Kong and Singapore. We need to direct our collective energies towards growing our financial markets and the economy.



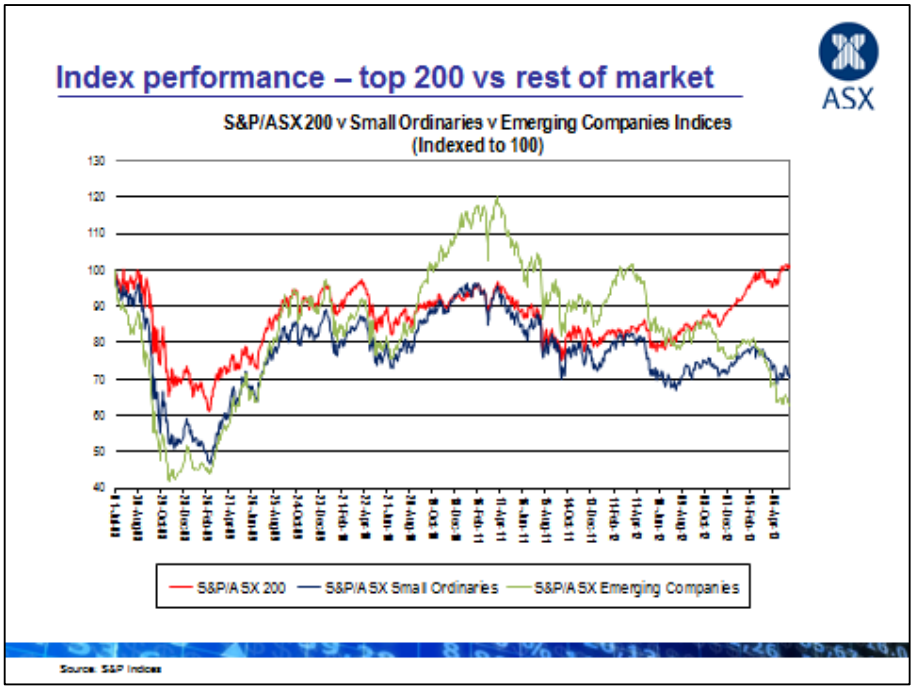
Today I will cover three topics. First, I will discuss recent market activity. Second, I will summarise the good progress we have made in settling-down Australia's market structure. While there is some final housekeeping to do, I am hopeful that we will soon have a period of regulatory 'peace' that allows us to focus on growing the pie. And finally, I will update you on ASX's new product and services offerings.

Recent trends in financial markets



The good news is that trading volumes have improved in the last few months. As you can see from the slide, the daily average value traded is starting to trend upwards, albeit from a low base. This is encouraging because all of us in this room know how difficult it has been over the last few years. In the first quarter of the current financial year the value of equity traded was down 28.5%; in the second quarter value traded was down 8.5%; and in the third quarter value traded was up 8.9%. This improving trend is encouraging.

In Australia, there has been a divergence in performance between the S&P/ASX 200 and the rest of the market.



The divergence can be seen in this chart, which compares the performance of the S&P/ASX 200 (red) with the Small Ordinaries (blue) and the Emerging Companies (green) indices over the past five years. This can in part be explained by the resources cycle. We need to work hard to support the companies outside of the top 200, of which there are some 1,800, many of them in the mining and resources sector. I will expand on some of our initiatives later.

Revenue growth by business

	3Q13 $M	% Variance	YTD Mar 2013 $M	% Variance
Listings and Issuer Services	31.9	12.0%	105.5	8.7%
Cash Market	29.2	2.4%	84.1	(11.9%)
Information Services	15.5	3.1%	46.1	(7.2%)
Technical Services	12.3	12.7%	36.9	10.1%
Derivatives	50.0	14.8%	144.3	3.0%
Austraclear	9.6	7.2%	28.7	7.4%
Other	3.9	4.1%	11.5	(1.1%)
Total Revenue	**152.3**	**9.5%**	**457.1**	**0.6%**

Variances expressed favourable/(unfavourable), all comparisons are to prior comparative period (pcp)

For ASX as a company, the improvement in market activity is showing in our results. In the first quarter, our revenues were down 8.8%. In the second quarter, they grew modestly by 2.8%. In the third quarter, revenues grew 9.5% as activity levels strengthened, particularly compared to a relatively weak corresponding period in the previous year. For the nine months to the end of March 2013 our earnings were essentially flat. This is not where we want to be, but it is certainly an improvement over the first half when our earnings were down 5.3%.

The state of market regulation

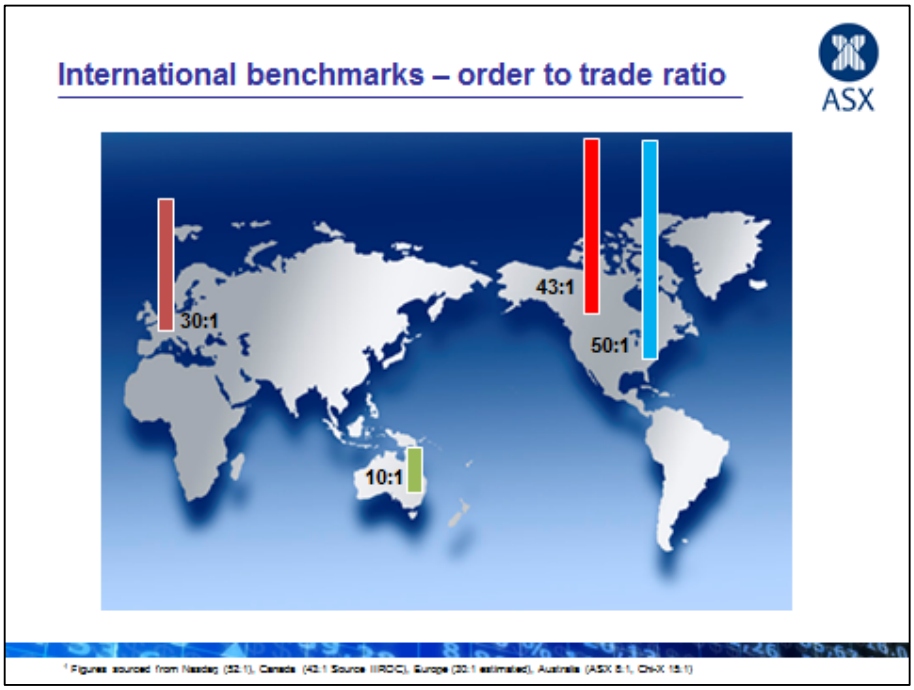
Let me now move on to the state of market regulation.

Since the introduction of Chi-X, and the resulting fragmentation of our equities market, our regulators have grappled with the challenges associated with high frequency trading and dark execution. ASIC and the Federal Treasury spent a lot of time consulting on these issues. We all spent a lot of time making submissions.

I believe that on balance they got things right. They made sensible decisions that will preserve the integrity and quality of our market.

There are still a few things to close-off and we need to ensure we get those final decisions right as well. After that, my hope is that we will enter a period of relative calm, with regulators and the private sector able to focus on initiatives that help grow our markets.

I will briefly comment on the two hot topics: high frequency trading and dark execution.



When we compare Australia to the United States we can see that the impact from high frequency trading is much smaller in Australia. ASIC estimates that high frequency trading accounts for around 22% of trading activity. This is manageable.

The reason for the lower impact of high frequency trading locally is quite simple. While Australia has allowed the market to fragment with the introduction of competition it has avoided several of the pitfalls to which other countries have fallen victim. In particular, our regulators have made sure that the economics of high frequency traders are more aligned with the interests of the broader market. They have done this by avoiding distortive pricing models, such as 'maker taker' pricing, and by ensuring that the regulatory cost-recovery charges are based in part on orders and not just on trades. This means that participants who create a lot of activity without doing a lot of trades, pay for the activity they generate. As a result, order-to-trade ratios have stayed within reasonable limits.

This all sounds good, but we are not quite done. ASIC is conducting further consultation on controls around high frequency trading. There are two changes that we need to ensure we get right.

The first relates to tick sizes. There has been a suggestion that Australia should narrow the tick sizes for some securities; for example, securities that trade predominantly at the minimum tick. It sounds tempting but in our view now is not the time to consider this. Narrower tick sizes will stimulate high frequency trading by reducing the liquidity at each single price point. Narrower ticks make it easier to be at the front of the queue, which is what high frequency traders do for a living. Moreover, narrower ticks will make it easier to internalise trades into private dark pools, at a time when ASIC is trying to reduce the growth of dark pools.

We know from other jurisdictions that have narrower tick sizes today that they are looking at widening them again. Australia probably got this one right, and certainly 'more right' than some other countries.

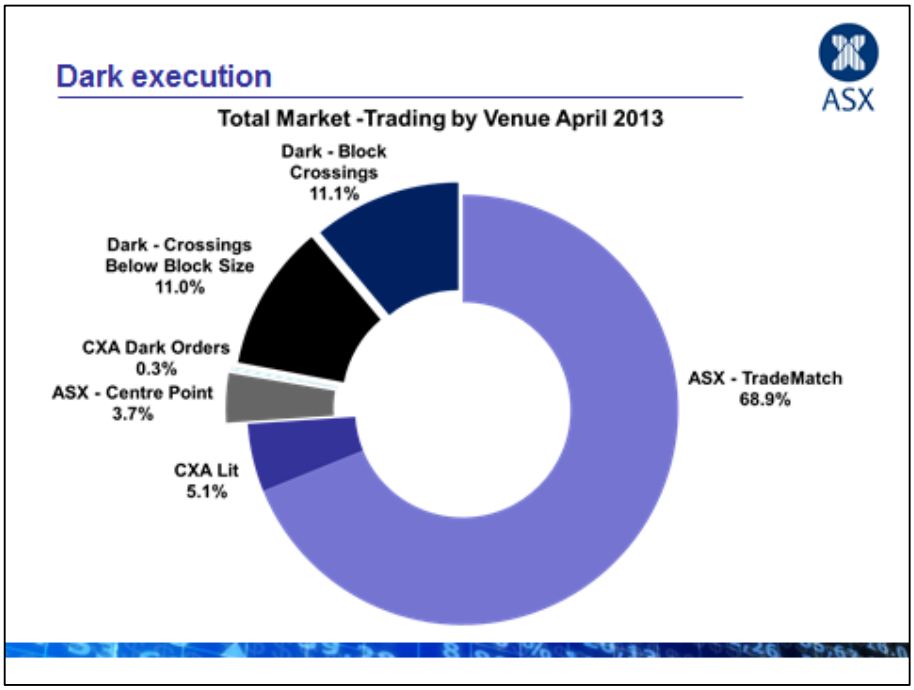
I note from the Stockbrokers Association's own submission to ASIC that many of you also believe there is no strong case for change at this time.

The second possible measure to briefly discuss is a minimum resting time for small orders. The idea is that a 'speed limit' will make it less attractive to trade small orders, which will then increase the average order size, possibly limiting the impact from high frequency trading.

The idea of a speed limit sounds tempting. If an increase in speed is assisting high frequency traders then a reduction may slow them down. Sadly, this is not how the logic flows. It is true that there is an issue with small trades. Some of you have expressed concern about it. Today, some 40% of all trades on ASX are below $500. It used to be 10%. However, if we dig into the numbers then we see that the increase is not driven by high frequency traders. Instead, the growth in small trades is driven by broker algorithms that break up trades from real investors. In other words, the issue is the number of small trades, not their speed. Therefore, a speed limit will not make a difference in practice and it will be expensive to implement. The better path is to work with the broker community on the use of algorithms.

Finally, a minimum resting time may have unintended consequences. It may give high frequency traders another arbitrage opportunity at the expense of genuine investors. Remember, they are better than anyone else at exploiting complexity and speed.

ASIC has done a good job in managing the impact from high frequency trading by aligning the economics of HFT with the rest of the market. It works. This is not about trying to stop innovation or trying to outsmart those who are smarter, nor is it about banning HFT completely. After the economics are aligned we should allow innovation to chart its natural course while always staying close to developments to ensure they are supportive of the overall market and not harmful.



The other major market quality issue impacting on our market is dark execution. This slide is the latest information we have from April this year, which measures 'dark' markets versus 'lit' markets. This information now appears on the ASX website each week so people can see what is going on.

As you can see, between 25 to 30% of our country's share trades occur in the dark. While we have always had off-market trading for large block orders, the increase in dark pools and internalisation can become an issue. We must have quality 'lit' markets with a sizeable majority of trade flowing through them. It is critical for price discovery and capital formation.

ASIC has once again done a good job in this area. It has recently adopted Meaningful Price Improvement and continues to look at the benefit of implementing a 'threshold'. ASX remains in favour of a threshold but recognises that we may first want to see what positive effect Meaningful Price Improvement has without the impact from other measures.

The regulators are also looking at licensing dark pools to ensure there is transparency for the end client. ASX supports ASIC's work in this area.

The final major issue that government and regulators have been looking at over the last 18 months is the market structure for clearing and settlement of cash equities. Australia's clearing and settlement infrastructure for cash equities is efficient, well-capitalised and well-regulated. In February this year, the government accepted the advice from the Council of Financial Regulators and determined to retain the current market structure for equities clearing and settlement for the next two years. We believe this was the right decision.

The government asked ASX to develop a Code of Practice for the clearing and settlement of cash equities in Australia. We committed to do this and are well on the path to developing it. We have already consulted on the draft Code and received constructive industry feedback. The Code is expected to be operational by 9 August this year.

My hope is that we will soon enter a period of relative peace where we can focus on growing our markets, not just in equities but in fixed income and derivatives as well.

ASX's plans

This brings me to the final part of what I want to talk to you about today - ASX's plans and business initiatives.

Business initiatives update

Business Area	Current Focus
Listings and Issuer Services	• Listings – flexibility, rights timetable, reporting, research • Expansion – Australian G'ment Bonds, Managed Funds
Trading Services	• Product development – Centre Point • Market connectivity services • Customer alignment – revenue sharing
Cash Clearing and Settlement	• Code of Practice implementation • Cash market margining • Customer alignment – revenue sharing
Derivatives and OTC Markets	• Derivatives – VIX, sectoral futures, electricity • Post trade – OTC clearing, client clearing
Austraclear	• Collateral management

ASX is one of the top 10 exchanges in the world based on market capitalisation. We are a multi-asset class, vertically integrated company. It is a great business that is core to our economy. It is also a business that can do more to bring new services to market and engage with its clients.

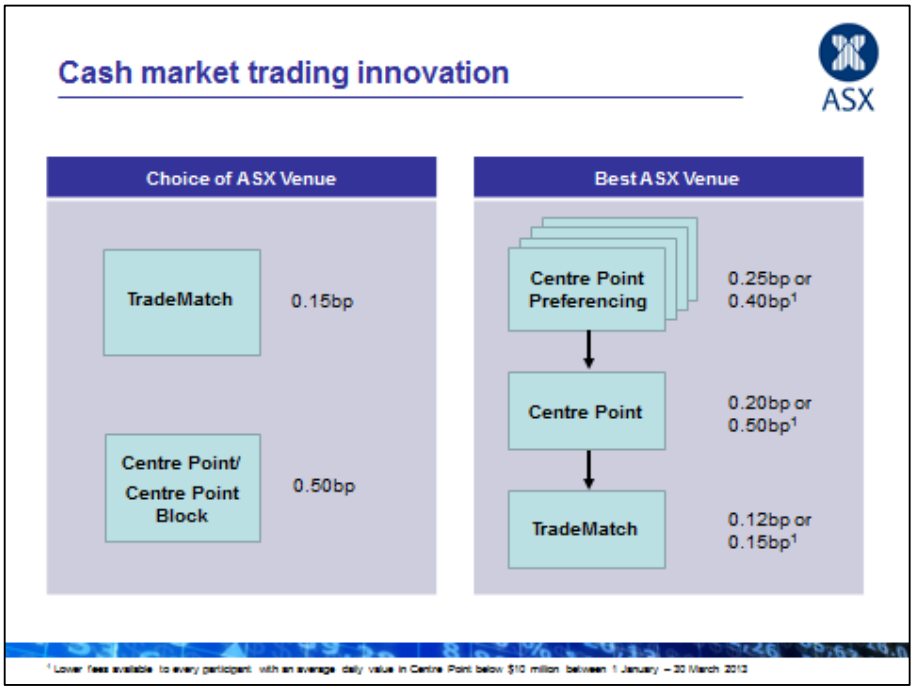
Over the last 12 months we have made good progress in most of our businesses. I would like to briefly comment on three of them.

In the area of Listing and Issuer Services, we have completed a number of initiatives. In August 2012 we implemented changes to the capital raising rules for small and mid-cap companies, allowing them to raise up to 25% of their capital base without specific shareholder approval, provided they get general approval for the program at their AGM. In the first year, almost 600 companies received AGM approval.

Other initiatives include the launch last week of Exchange-traded Australian Government Bonds, new rules for the disclosure of reserves and resources in the mining and oil and gas industries, an Equity Research Scheme, an improved rights issue timetable and a new Managed Funds Service. All of these initiatives are progressing.

We have also flagged that we will ask for input from the market on the best way to improve liquidity in the small and mid-cap sector. Now that many of the other consultation processes are behind us, we will put some ideas to you for feedback.

The second business to briefly touch on is Trading Services. In this business we continue to innovate our execution offering.



The slide shows what we have just launched. On the left you see the traditional offer, whereby you have a choice of venue – ASX TradeMatch or Centre Point. On the right, you can see what we have moved to. The right allows you to get the best outcome from us automatically. If you follow the chart down, we start by trying to match your order in Centre Point with other orders that you might have. We call this Centre Point Preferencing. If that does not create a result, we try to match your order with liquidity in Centre Point. And if that does not work, your order is executed on TradeMatch.

You can see two separate fees on the right for each step. The top number is part of an introductory offer for customers who have not used Centre Point extensively. When you look at the fees on the right you see that the final step has an introductory fee of 0.12 basis points. This means that there is no downside to trying the service. And you do not need to have your own dark pool. We do the work for you.

Next to the initiatives in our Listings and Trading Services businesses, we are making significant investments in Australia's post-trade infrastructure. This includes new services such as clearing of over-the counter derivatives and collateral management. They will bring new efficiencies to the Australian market and will ensure that investors have a choice to use a world-class solution based in Australia and regulated under Australian law.

In this speech I can only highlight some of the key initiatives. There are many others that we hope will grow our financial markets and make them globally competitive.

Conclusion

I hope that you found this update useful. Next year, many of our new services will have launched. I look forward to updating you on how they are going at your next conference.

Again, thank you for inviting me to speak today and for your continuing support of ASX.

END