



## Edited Transcript of ASX FY 2011 Analyst Briefing

18 August 2011

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**Andrew Hills, Pegasus Securities:**

*The alternate trading venues overseas to the incumbent exchanges are talking about offering more than just cash market services, they are increasingly talking about offering various listing services and I am just wondering, my question is, is any of your product development focus outside the various new trade execution products and other cash market initiatives that you talk about regularly?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I won't comment on the likelihood of that occurring in Australia because of course you wouldn't expect us to. The comment I made around the outside of the top 200 segmentation of that offering I think is an indicator of, I guess, awareness of the possibility of a competitor in that space providing something to smaller listed companies that the current offering does not provide. I think we are alive to those kinds of dynamics. Of course the job of the exchange anyway is to try and retain a relevance around its offering, regardless of the likely prospect of a competitor arriving tomorrow or in six months' time or in two years. I think the point I made around this unbundling of the service offering is really a sort of lead indicator on the expectations we think our customers have, and a failure to do that is inviting a competitor to provide that service if we don't.

**Andrew Hills, Pegasus Securities:**

*Thank you, just one more quick question. Given you've got quite a large, I think its \$200 million investment in IRESS, why did you effectively provide a beach head entry into Australia for their largest international competitor being Fidessa?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I think we will each have a go at this one. We regard IRESS as an outstanding company and an outstanding investment, so that's our baseline view on IRESS. I think we also take a view that it may not be in our medium to longer term interests to see the level of dependency on IRESS for our distribution and our overall product and service offering. We are told competition is good and we have swallowed that mantra, and I think we have executed that via the Fidessa decision. It's not a strategy that's designed to put IRESS in the ground or anything resembling that because we have so much time for the company and we continue to work extremely well in a partnering sense with IRESS, but we feel the Fidessa offering is a global offering. It's tried and proven and at a time when we are going forward, we are going to resemble far more of the other global markets, at least on the equity side in the first phase, we feel that made sense. Do you want to add anything Peter [Hiom]?

**Peter Hiom - Deputy CEO, ASX Ltd:**

Only that it may not be apparent to you that we already do compete with IRESS, but we actually do already with a front end application that is only pointed at the ASX market currently. That product will become redundant in a multi-market environment, and we saw no reason to just turn that product off and not seek to replace it with a product that would work in an environment with more than one platform. In talking to our customers, we think there is room for more than one smart router provider in Australia, and we saw this as an opportunity for us to participate in that.

***Nigel Pittaway from Citi Investment Research:***

*A couple of questions if I may. The first one is on the capital position. I think you described that as comfortable and sufficient. My understanding is that with cash market margining, that only gets bigger and I know you are citing things like OTC [over the counter] clearing as potentially eating into that. I think previously you said that impact would be relatively modest, so my question is can you please update us on how much of that excess you expect to be eaten into by upcoming changes, and at what point does that comfortable and sufficient capital position become excess?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I think if you read Ramy's written narrative carefully in the CFO's Report, it really talks about, I guess, some of the looming potential or contingent calls on capital coming down the track. With OTC derivatives clearing, it's impossible to tell from the RBA consultation paper what the scale of that market is going to be because whether it will be confined in the first instance to clearing domestic coupon swaps or whether it will be as ambitious as cross-currency swaps, all of those stage developments will no doubt have the potential to fundamentally change any capital allocation we might make to clearing OTC interest rate swap derivatives if we do in fact go down that path. The CPSS IOSCO standards that were published three or four months ago now clearly foreshadow, if you read the standards in their current form even though they are only at consultation phase, they clearly foreshadow a likelihood of the greater capital requirement going forward rather than a lesser capital requirement going forward. I won't make any predictions about what the outcome of the consultation will be, but I suspect if you look at the timeline for the Dodd Frank target dates being the end of 2012, then we are working on the assumption that we will get clarity on CPSS IOSCO capital requirements sometime during calendar 2012. So I think they are probably the two areas where at the moment we have fog but I suspect that fog will lift during calendar 2012, so that is the basis for the kind of comfort statements that Ramy's made in the written word.

***Nigel Pittaway from Citi Investment Research:***

*And maybe a question for Peter. I was wondering if you could in broad terms outline what will happen, what you expect to happen to your overall revenue take in the various areas as you engage in unbundling?*

**Peter Hiom - Deputy CEO, ASX:**

Well I don't think I can give you an answer that wouldn't constitute some forward looking statement that we wouldn't be prepared to provide other than I think we have made previous indicators that we expect, and you can see it coming through the numbers already, that the revenues through the technical services and connectivity lines will rise disproportionately to those in other revenue lines of transaction services. I think the transaction business of the derivatives market is running healthily at the moment, but I think you will just see that that line is one that we expect to grow and out perform as the new data centre comes on line and, in bringing that service to the market, identify other opportunities that sit outside of the transaction business that we can exploit through that facility.

**Brian Raymond from Macquarie Securities:**

*A question on cost guidance. Looking at staff costs increasing 5% which you mentioned earlier in FY12, but overall cost guidance in line with inflation which I suspect is below 5%, where do you expect to be able to contain costs or manage those costs in order to get that overall inflation rate level?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

We are obviously I think pretty vigilant. I am trying hard not to look at Russell Gill here because he ribs me every time we do a results release that the cost guidance we give we have never positively looked up, we have always done better than we have indicated. I think we are always pursuing productivity benefits wherever we can to try and offset, really, what I think is an organisational commitment to make sure that we benchmark and pay our talented staff as well as we can. There is no doubt that going forward the cost pressures will be far more on the staff line than any other line and we will be doing everything we can to deliver savings from occupancy costs, equipment costs and obviously discretionary administration costs. I think the likelihood that we will be able to sustain the kind of year-in year-out cash cost performance we have delivered for the last five years, bearing in mind that our cost base today in nominal terms is still \$30 million lower than it was five years ago at the time of bringing the two exchange groups together. I think the likelihood that we will be able to do that is fast receding, because with greater market fragmentation and complexity we will have, as Peter [Hiom] alluded to in his summary remarks, to speed up the number of projects that we are executing, the number of platform upgrades we do, etc. I think the period of cost stability that you have observed is probably past but I think the guidance we have given around targets CPI is still going to hold, at least for most of the cost categories. But we will look for productivity benefits outside of the staff line wherever we can.

**John Heagerty of Credit Suisse:**

*A question for Peter [Hiom]. I was wondering if you could provide a bit more detail on the tailoring of cash equities clearing and settlement services for different types of users, and the likely impact on the fee revenue of the clearing and settlement functions?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

Sorry John [Heagerty] I missed it, was it collateral management you asked about?

**John Heagerty of Credit Suisse:**

*No, the tailoring of cash equities clearing and settlement services. It's the unbundling of the fees. The first bullet point in your looking forward section.*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

So this is the unbundling?

**John Heagerty of Credit Suisse:**

*Yes, and how you expect that to impact on your clearing and settlement fees?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

Well I think the unknowns there are of course the arrival of CHI-X and what uplift we get in high frequency trading as a result of that. We clearly as a clearing house, as opposed to an exchange, are looking to see what opportunities there are for us to grow that clearing business with a different fee model for high frequency traders

than the one we currently have. Now what we don't know, of course, today is what will happen to the overall transactional volumes of the market after the arrival of CHI-X. It's hard to answer the question as to what impact we think it will have, but suffice to say we expect to be able to provide high frequency traders with a more attractive fee structure than the one we can provide today without that impacting on the value proposition that we deliver to the rest of the market. And we will seek to do that in a way that enables us to maintain the value of the franchise.

***John Heagerty of Credit Suisse:***

*OK. So just clarifying at the moment, basically you are saying for high frequency traders it's likely to be a slightly cheaper fee so even if CHI-X gets going you would like to bring down new high frequency traders to the market? Your average fee might come down so the net benefits might not be as much as you might have anticipated?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

Well, I mean it will be a question of where we set the fee, what levels we set the fees at and obviously what the overall turnover of the market and what proportion of that market is described by high frequency traders will be. I am only telling you things you know of course, which will all be drivers of what the revenue outcome will be. We are unlikely to make those fee changes this side of seeing some of those mix of trading participant types in the market.

***John Heagerty of Credit Suisse:***

*Right, OK so we will find out in 2012.*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I don't think you are going to see anything in the first half of the current financial year. It will be well into the second half and probably more realistically FY13 before you see the kind of trends Peter [Hiom]'s alluding to, and we are not sitting here John [Heagerty] forecasting those trends. I mean we can make assumptions, but they are pretty heroic assumptions as those of you with models would know all too well. We just have to wait and see how the first year of competition for market services plays out.

***John Heagerty of Credit Suisse:***

*Finally, are you concerned about the potential increase in competition in clearing and settlement at all?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I think Peter [Hiom] alluded to this in Andrew Hills' earlier question. I mean we are alive across the entire value chain of our activities, whether its listings, data, trade execution, clearing or settlement and we differentiate between clearing and settlement. We are alive to the possibility or probability of competition in any or all of those segments. We wouldn't be good stewards of our assets and cash flows if we were in some sort of denial process. All we would say is, whilst a lot gets written both in industry journals and from sell side analysts about European and United States market precedents, the scales that flow through those markets just have no application to Australia, so I suspect we are in for a period where there will be a lot of talk about competition and competition will become the flavour of the month topic for people to discuss. Whether the scale of the market is here to support multiple listings competitors, multiple trade execution competitors, multiple clearing houses or multiple settlement systems, you can tell from my tone I personally doubt that. So I suspect we are in for a hyperactive period of commentary over the next 12 to 24 months and then it will settle down to its natural, restful state and if the natural, restful state means we end up with two listing exchanges or five trade execution platforms then the

economics will be determined by that outcome. I think the European and US precedents are being a little bit overblown and over quoted because those markets are multiple the size of ours. Next question, I think Russell [Gill] has got his hand up.

***Russell Gill of J.P Morgan Securities Australia:***

*Rob [Elstone] two questions, firstly going back to the IOSCO report, it does highlight a huge amount of capital required in clearing houses, particularly across the default of two major participants potential double margining and the like. Irrespective of where that actually does go in the capital requirements, can you possibly give us a feel for what potential impact that actually may have on trading activity in the market place if participants have to increase their capital requirements?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

It's an impossible goal, I was going to say it was a difficult question to answer Russell, it's actually an impossible question to answer because of the volatility. If there is a move from the single, largest single counterparty defaults standard to extend that to two, first of all it's not a linear risk profile because that risk profile changes every day via mark to market arrangements as asset prices change and as clearing market shares change across clearing participants. Yes, the capital requirement would go up, but I think there are really a couple of challenges. One is it tends to be a very, very spiked requirement, particularly around index arbitrage processes around expiry time, so whether it would be necessary to carry permanent capital all year for events that drive peaks in exposures is a point that I think is yet to be processed through the CPSS IOSCO process. I think we are probably almost more troubled by the proposed liquidity standards than the capital standards because that would require the CCPs around the world to hold really potentially very, very high standby facilities and then you get into second order issues of how dependable those standbys be in the event of a default. But I think, it's impossible to give you personally or the market guidance because until the decision is made it would be misleading for us to make statements. Even if that were to become the standard I think a) there is this issue of the peaks and spikes and whether that could be dealt with through mechanisms other than fixed permanent capital, and then secondly, it varies so much from one day to another. Clearly I think it goes to Nigel [Pittaway] from Citi's earlier question, it is the reason why we are not contemplating running down our non-attributed capital allocation position at the moment.

***Russell Gill of J.P Morgan Securities Australia:***

*And a second question, it may look a bit in hindsight but is there any flexibility around the SFE derivative rebate hurdle at all?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

Can you restate the question? I just didn't catch one nuance of the question.

***Russell Gill of J.P Morgan Securities Australia:***

*Just it looks, the question is more in hindsight now given the derivative volumes of the last six weeks.*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I have been in that taxi in Sydney quite a few times with Harry Hindsight driving me around. Look, I think we have explained before. We do find it difficult to see that the futures market volumes we have observed in the first six weeks since balance date are going to constitute the new base. I mean already in the last three days, and I am not telling the market anything you can't pick up from reading the daily pages in the Financial Review here, in the

last 3 days as the equity market volatility has come back to more normal ranges, futures markets have responded. I think the two central bank interventions we saw, from the Bank of Switzerland and the Bank of Japan, eight or nine days ago had the practical effect of blowing up a lot of inherent profitability in carriage rate activity which was really driving the volumes since 30 June. I would expect, although our August activity statements are still going to show reasonably robust futures volumes, I think for you to multiply July and August by six to get a 12 month view, would be extremely dangerous and I would caution you against doing that. I wish you could by the way, but I don't think you should.

***Richard Coles from RBS:***

*Expanding on from John [Heagerty]'s question. Can you maybe give us some comments on inter-operability and what you think that means for you given it's rapidly increasing overseas?*

**Peter Hiom - Deputy CEO, ASX Ltd:**

I think you are right. It is starting to take route in Europe but I think the application of inter-operability in Australia will be a function still of the market's preparedness to capitalise a second clearing house which we have no particular view on. I think adding to Rob's comments, we think we are doing all the right things. We would say that, I guess. We think we are doing the right things around fee structures, contemporising the margining regime, creating stickiness by cross margining between futures and cash equities and expanding the service offering into the OTC market. Beyond that, if the market wants a second clearing house then that is a short jump between that and the question as to whether there will be inter-operability between those two clearing houses or whether there won't be. That will just add another layer of cost and complexity to the business case of a second clearing house stacking up for the market.

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I think we should just add to Peter [Hiom]'s comments that, although the issue of clearing competition also needs to be seen in the context of the settlement side of the equation as well. And one differentiating market structure feature of the Australian market, we really have a delivery versus payment model No. 3, which is unlike model No. 1, that prevails in the London and European markets for example. Model 1 being a trade by trade clearing and settlement process; Model 3 which is the one we have here in Australia, really involves huge netting and payment system efficiency through the batch settlement process. That doesn't mean that the case for clearing competition is much weaker, but it does mean that the clearing participants are confronted with not only issues that Peter [Hiom] has responded to which is 'do they want to put more capital up?'. But if you start opening up the risk of moving from Model 3 to Model 1 you lose an awful lot of capital efficiency in the current batch settlement process. So this is quite a complex area that, unfortunately, most of the people that write about clearing competition probably are not really across. But I think both Peter [Hiom]'s response and mine hopefully answer your question.

***Kieran Chidgey, Deutsche Bank:***

*A follow up question to Russell [Gill]'s question around the SFE rebate structure. I take on board your comments, obviously we are very early into the year and with hindsight possibly wouldn't have set a threshold of 2.5%. Given that and given FY11, we also saw volumes well in excess of the 7% hurdle I think it was last year, whether or not you are comfortable with the way that structure works or whether or not you think you are giving too much away in terms of our biggest revenue pie?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

Perhaps I should put you in a room with our participants Kieran. We could referee that discussion. I think it's a really good question and I won't say one thing in this forum and another thing when I am talking to participants. Quite frankly, the larger the rebate cheques we can write out to participants the more happy we are. I think that's the best way of answering the question. As you know only too well it's an art not a science. We set these growth qualification thresholds around about May/June. We set them for 12 months in advance and we honour them. We don't chop and change and try to explain to participants after the fact that we got it wrong with hindsight. I don't think that would go down too well. But I think the bottom line is the bigger cheques for rebates we are writing out to participants, the happier we are because we think shareholders are still benefiting. Once you get per annum growth in excess of 15%, the fact that shareholders are only getting 25% of that increment I don't think is any grounds for complaint, because I think the liquidity begets liquidity syndrome is alive and well, and we obviously went through that period after the credit crunch in 2008 where futures markets took a bit of a bath. We have been absolutely delighted with the rebates levels we have set to see them come back as strongly as they have in the last two to two-and-a-half years.

***Anthony Hoo at Nomura Australia Ltd:***

*Just a question on your CAPEX outlook. In light of your earlier comments around shorter upgrade cycles in the light of competition coming in, should we expect a new higher base for CAPEX? Ramy has given us very detailed guidance for the current year, but looking past the current year?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

It's a really good question and I think the guidance Ramy has given is probably fine for FY12 that if you back out that \$10 million which has been allocated to round out and finish off the data centre, it looks as though it's going back to the \$25 to \$30 million range base that we have established over the previous four or five years. But I think your question is spot on. There is no doubt that with the number of projects we have on the go there is a risk that the CAPEX base could go up or might need to go up. The constraining factors on that happening is really our ability to actually deliver X number of projects in any one year and that comes back to the people constraints and expertise constraints that we face. It's one of the reasons why, in response to the question that we got on cash operating costs, it's why we are very committed to making sure that our fixed remuneration levels do not get out of whack. So I think the pressure is upwards but if it lifts up above that \$25 to \$30 million historic range other than for lumpier investments like the data centre, where we are not resource constrained on the data centre because we didn't build it, we outsourced that to a developer and a specialist data centre builder. The pressure is upwards, but I don't expect we could logistically spend it faster or spend it, or spend more, at least on our organic growth development profile. I think we are probably subject matter in human resource constrained, so if it goes up it will go up for very, very specific reasons probably associated with technology purchases. So the pressure is upwards but don't go away from this cut of the briefing saying, well, could \$50 million become the new, I think that is most unlikely.

***Chris Williams from UBS:***

*I have a couple of questions and one point of clarification. Your data centre or technical services revenue were up 35% in FY11 and looks like they are up about 15% sequentially in the second half. Can you give us a sense about the current sort of capacity utilisation in the assets that underpin those revenues and what sort of capacity increase you are actually delivering to the new data centre facility later this calendar year?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I will have a go but I think you have the first go. [Peter Hiom]

**Peter Hiom - Deputy CEO, ASX:**

In a technical sense it is straight forward, we have a small co-location facility at the moment which is largely at full capacity, it's about 80 racks. The new data centre has a capacity on level 1 of 600 racks. We have an option on level 2 that we haven't yet exercised, we may choose to, which would deliver another 800 racks. Clearly we wouldn't expect low latency customers to be fully utilising that facility so there will be other customers we will be seeking who are non-latency sensitive to occupy as much as that data centre as we can and are considering our options in that space at the moment.

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

But Chris please don't put a linear function between capacity and revenue based on that response.

**Chris Williams from UBS:**

*That's fine I understand you are going to cross sell a lot more services than just racks into that facility. My second question was around OTC [over the counter] clearing. I understand your earlier comments Rob about the very preliminary nature of the discussion paper that's out there but it seems that the market structure, particularly if interest rates swaps lends itself to some sort of joint venture or mutualised or semi-mutualised structure in that clearing facility. Is that something you are contemplating?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I think on the ownership model and the business model of anything we might do in the OTC interest rate swaps basis there are still open issues. We don't have a closed mind and I think if you read the RBA [Reserve Bank of Australia] consultation paper, which I am sure you have, the way that's worded, clearly the threshold issue is really whether it's going to be an onshore CCP [central counterparty] organisation or a leveraged offshore. If it's onshore we think we are as well placed as anybody to deliver a service offering into that but there are so many ifs, buts and maybes. The first one is onshore versus offshore. If its onshore, which our expectation is that it will be an onshore CCP, then you have got the inter-operability issues because that goes to also the product set being probably confined in the early days to domestic coupon swaps and then expanding into cross currency swaps further down the track. However I don't think on the business model per se and governance, in particular who owns it, or if we own it what the revenue sharing arrangements or the rebate mechanisms might be. I don't think we are at a stage yet where we have either got a closed mind or definitive outcome. We simply don't know enough yet about the shape of the Reserve Bank's preferences and the preferences of what we know to be is a very diversified un-unified set of particularly domestic bank views on what shape that venture should take. I think a corollary of what I just said is we certainly are starting to feel that the deck 2012 deadline is very, very ambitious for that initiative.

**Chris Williams from UBS:**

*And could I just clarify in response to Nigel Pittaway's earlier question about margining for equities and the fixed capital and subordinated debts sitting behind that business. There is some suggestion that perhaps margining the variable capital might substitute for that fixed capital, that doesn't seem to be my understanding. Can you confirm that the margining framework is seen by the Reserve Bank as an additional layer of risk protection not a substitute?*



**Robert Elstone – Managing Director and CEO, ASX Ltd:**

I think that's a very safe working assumption. I think dialogue with regulators these days about reducing capital is a very short conversation.

**Ryan Fisher, Goldman Sachs and Partners:**

*Two questions, first one relates to futures again and with the LVR I was just wanting to confirm in the past I think there have been other rebate schemes running alongside the LVR, could you comment if they are still there and how significant they are or if the LBR now accounts for the majority of turnover?*

**Ramy Aziz - Chief Financial Officer, ASX:**

Yes Ryan, as in prior years we still have the large, the proprietary rebate scheme, which is there which is based on the level of monthly volumes traded by those proprietary traders. So that's there and I think in my notes I give some guidance as to how large they are as a proportion of the market. They are just under 20% of the market in terms of their volume contribution.

**Ryan Fisher, Goldman Sachs and Partners:**

*Would it be safe to assume if we used the rule of thumb on LVR, the 15% sort of level that that is fairly safe across the whole book or should we adjust it?*

**Ramy Aziz - Chief Financial Officer, ASX:**

I think that is fairly safe.

**Ryan Fisher, Goldman Sachs and Partners:**

*Thank you and the other question perhaps for Rob in relation to the government. Is anybody any the wiser about what exactly they are concerned about in relation to clearing and settlement and more to the point if and when they are going to clarify the terms of what they are investigating?*

**Robert Elstone – Managing Director and CEO, ASX Ltd:**

Short answer, no. No one is the wiser. I think the statements that have appeared on, I think it's the Treasury website, is to the likely terms of reference of the working group of the Council of Financial Regulator's Review. Nonetheless consistent with our understanding at the time of Treasurer Swan's comments on the rejection of the merger, namely concerns about systemically important infrastructure and sort of step-in powers under periods of extreme volatility and stress. So we have no inside oil and probably even if we did we wouldn't disclose it, but we don't have any inside information on that point beyond what I have just said.

Ends