Edited Transcript of ASX FY 2008 Media Briefing

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Peter Smith, Financial Times
Can you give us an update of where we are with the competition and new licences issues?

Robert Elstone, CEO & Managing Director ASX Ltd:
I can't really give you an update in a timing sense because I am not the government. But the ASIC consultation process finished, I think, in March of this year and the government has been deliberating with various public statements which have been made, I think, by Senator Sherry. There is really not too much more I can say on the likely timing or nature of what the government's decision will be on that topic.

Simon Palau, ABC TV
The fragility on the local equity markets must be putting a bite on the ASX.

Robert Elstone:
Depends which metric you look at. If you look at trade execution volumes you could argue that the volatility hasn't really translated into putting the bite on ASX because the percentage uplift in the volume of transactions that we are processing is not only double digit but it is very high double digit - 56% up for the six-week period between July and August is an example. The value of the trades that we are processing is clearly down so that has a much lower growth rate by value than by volume but you would expect that given that most global indices are off somewhere between 15 and 25% depending on which market you are talking about. So putting the bite on, I don't really think that's probably accurate because there is always a counter factual view that volatility is a good thing for exchanges because it tends to mean that there's lots and lots of volume going through the market.

In the last 12 months we have to delineate that there have been two issues occurring: the issues surrounding the global credit crisis have really gone to confidence and the equity markets have reacted to that and that goes to sentiment; and at the moment we have got this interplay between sentiment and confidence and they are different phenomena. I think sentiment is more of a cyclical phenomenon and people are trying to guess when values will come back. Whereas at the moment with global credit markets staying extremely nervous, we actually still have an ongoing confidence issue about the stability of financial systems all around the world, and particular individual financial institutions but certainly in our statistics so far I wouldn't say it qualifies as a troublesome period.

Broadly for the year it doesn't look like a troublesome period, but in the second half you have seen a fall in profit growth, probably due to volatility on global equity markets, is that a fair call?

Robert Elstone:
That is a fair call. Mathematically it was only about 4% below the first half so it wasn't a serious slowing but given the activity levels I am quoting for the July to mid-August period, that appears to be carrying on but it could change very quickly in the current year because sentiment shifts in asset markets which can be very, very profound on the upside and the downside when they occur. But it was slightly softer in the second half. But I don't regard a 4% profit difference one half on the other as a troubling or a worrying trend.

Even if it continues, even at that rate?

Robert Elstone:
A lot will depend upon other revenue streams. I think probably the most concerning aspect at the moment is that the derivative markets both for interest rate derivatives and single option derivatives appear far more subdued and that's what you would expect as you see capital being taken out of the system and being allocated to very, very conservative assets. That means you are getting lower levels of proprietary trading activity by major banks. I don't believe it will carry on forever and there is still a large supply side of money coming out of the superannuation system and conservative asset allocation is not sustainable in the long-term with an aging population. People will be looking for higher returns but it's a guessing game on how long the current sentiment will take to shift or change.

Tony Boyd, Business Spectator
One of your competitors in the CFD market, someone from the OTC side, said that their turnover for a couple of days is about the equivalent of what you have done since November. Maybe that's overstating it, maybe its turnover in a month, but the point is that it seems as though the OTC market is still the preferred way for people to trade these instruments even though - as I think as you, ASX or other staff have pointed out it is less highly regulated, less secure, probably less integrity in the price discovery. Have you got any thoughts on why you think that might be happening and whether you think that the regulators themselves should be putting greater attention to what really is a far more risky way of trading?

Robert Elstone:
Our best level of understanding is that certainly ASIC's antennae are up in relation to the risks that are embedded in the over-the-counter CFD market, and in fact that was one of the reasons why we were encouraged by ASIC in earlier years to start an exchange-traded product alternative so that there would be greater transparency and greater certainty around the price discovery process and we have done that. But I don't really think it's for me or us to comment on the degree of anxiety or worry that the regulator may have. It's not a market that we regulate albeit some of the over-the-counter CFD providers clearly hedge and lay-off their risk in the market that we operate so they are playing in both the exchange-traded equity space and in the over-the-counter space. I am not going to dispute the stats because I haven't heard those stats before, but I think it is really a question that is better posed to the regulator. We are the supervisor of the markets that we operate. If we don't supervise another market then it's really not appropriate for us to comment on the efficacy of that market. We have concerns about the OTC CFD space and we have made those concerns known to the corporate regulator.

They don't seem to have acted on those concerns yet.

Robert Elstone:
No comment.

OK. On Tricom, could you just bring us up to date. Have all the issues there been resolved, all the deposits been returned and finally what lessons did the ASX learn from that particular experience?

Robert Elstone:
I will answer the second part of the question and perhaps have Eric, who is much closer to that wearing a supervision hat answer too. As far as lessons learnt, I don't think there were many and my basis for saying that is if you read, and I would urge you to read, the Reserve Bank's independent assessment of the equity settlement arrangements in this country which was done in the wake of the Tricom settlement delay, it's again a very thorough, very easy to read and a very clean assessment of both the circumstances surrounding the settlement delay and the efficacy and the efficiency of the settlement infrastructure that we operate. So, whilst we have implemented a couple of quite low-key recommendations, we are certainly seeing in the wake of those changes distinct improvements in settlement failure stats. Our rate of settlement failure is comparable to global best practice anyway so the fact that it is improving on an already strong benchmark is encouraging. But I would really urge you to read the RBA's report because it is pretty much a clean bill of health, and we have adopted a couple of recommendations that they made and they seem to work. But I will hand over to Eric on the first part of your question.

Eric Mayne, Chief Supervision Officer ASXMS:
Yes Tony I think the matters with Tricom are really getting towards the concluded end as opposed to where we were of course back in February. We are working quite regularly with Tricom and making sure that they have got all of their processes and procedures appropriately back in place. As you

know, they got an independent expert's report in relation to their processes and procedures, we are working with Tricom in relation to the implementation of those recommendations to make sure that they are all appropriately operating. We have of course ongoing investigations that we are still carrying out in relation to activities where we consider there may be potential for breaches of our operating rules and that will follow its course, and will continue to follow its course and we are in constant communication with ASIC in relation to this matter. Certainly, in terms of picking up from what Rob has said about the lessons around the settlement issues, and yes we have implemented a number of new measures around settlements in terms of increasing the minimum and maximum fail fees and also having obligations for participants to close-out positions where they are more than T + 5. If they are more than T + 10 they will be referred into our disciplinary investigation area to see whether or not further disciplinary action will be implemented and there are some improvements I think we have probably brought into the process post-Tricom.

The issue around short selling is set out in a consultation paper. Submissions have come in and we are still waiting for the decision from the government as to what the nature of the legislative change will be that is going to be put into place. Assuming that happens, we will then fall in behind that to then determine what changes we would make to our market rules to complement what we consider an important feature of any change: that is providing greater transparency in relation to covered short sales. There are also comments that are coming in in relation to the adequacy or the necessity to have stock lending statistics provided, and I think the general thrust of that is that it would be supplementary and would not be something that would be in substitution for disclosure or greater transparency around covered short sales.

Nathan Lynch, Complinet
Just a question about the new capital liquidity provisions. There seems to have been a bit of disquiet amongst clearing participants, especially smaller ones, about how this was introduced. There wasn't enough consultation and there has also been some speculation that it could lead up to 200 job losses as clearing functions get outsourced to third-party broker clearers. I am just wondering if you are aware of those issues and if so is this a fait accompli the way it has been portrayed to be?

Eric Mayne:
Yes, the decision has been made about the improvement, and there has been a lot of noise in terms of what the implications of that would be. I don't have details in terms of statistics about job losses. But certainly from ASX's point of view, and this is an area which is dealt with in our risk and operations area more so than in supervision, it's really working with the relevant participants that might be adversely affected by that decision to see what are the best ways of working through those changes and making sure that they are appropriate. Whether third-party clearing facilities are made available to them or they have access to that, but the changes are there to make sure we improve the systemic issues that we found and therefore to manage the potential risk whether it's investor protection or other risk into the market.

Robert Elstone:
All I would add Nathan is that we have a clear-cut license obligation to make sure that we have minimum capital requirements that satisfy the integrity of our clearing and settlement infrastructure. That's what guides us. The fact that there may be some job losses, and I am not dismissing those, but we have to comply with our license obligations. The view we have formed is that particularly these capital requirements have not changed for well over a decade, well over a decade, and yet clearly the risk profile and activity volumes through the market have grown exponentially.

In relation to the market licence applications from Chi-X and AXE ECN, if they are approved and it sounds as though a decision on that is fairly imminent now, does the ASX have a preferred supervision model on the assumption that two more licenses were to be approved in the near future?

Robert Elstone:
I think quite deliberately in our written words today and in my verbal comments, we haven't made any forward looking statements regarding the competition for market services issue, partly because we take the view it is a public policy decision of government. Secondly, I think as the whole market becomes informed of any changes to the regulatory framework - of which we would believe supervision and the arrangements of supervision are actually more vital from a public policy point of view than the issue of whether the licenses are granted or not. As those changes are made, if indeed they are made, then we will have more to say at the time that they are made. I think for us to say

anything more than that would be just dealing in hypotheticals and making speculative comments, and I don't intend to do that.

Matthew Drummond, Australian Financial Review.
Eric, in talking about the ASIC report, you said it contains recommendations that ASIC think are needed, I am paraphrasing here, but they needed to ensure that ASX has checks in place, that ASX indeed does have in place; there is something sort of nonsensical about that. If you had the checks in place ASIC wouldn't have needed to make the recommendations and for all the talk in the report about them being agreed actions between ASIC and the ASX, the report notes that you didn't agree with all of them. Aren't these sort of 10 detailed recommendations an implicit statement by ASIC that the ASX's supervisory arrangements, they might be adequate but they are not really up to scratch or particularly up to scratch for a bear market?

Eric Mayne:
Matthew thanks for the question. Not surprisingly, I guess I disagree entirely with your conclusion. The assessment identifies 10 areas where ASIC considers that further clarification is needed. More so I think for people externally and so that people don't get confused or misinterpret what are our obligations and what are things that we are required to do. Now, if you look at each of those 10 agreed actions, the first two go to providing clarification in documentation. There is no issue about the substance of how we manage our conflicts, there is no issue about the substance. In fact they do say positive things about the structure of the policy committee. Again it is cosmetic about how we actually provide reporting, whether it be internally and also to the subsidiary board. The next 5 or 6 recommendations all go to resources and they all go to questions as to providing greater clarification about the way in which we monitor and supervise our supervisory needs. ASIC makes positive comments and says that the way the supervision board monitors resources and the tools that it uses are quite effective and the whole process is quite transparent.

What they are looking to see is continued information on the role that the board plays in monitoring supervision resources. They then look to provide certifications, or what they call certifications, from me essentially that the budget I have asked for through the subsidiary board to the main board is the budget I have got; that the money I spend on supervision and that the way in which I arrive at the budget is the appropriate way to make sure I meet all of my supervisory needs. Again, there is nothing there to say that there has been a shortfall or a need for improvement other than saying we would like a little bit more transparency, again designed to provide people in the market, people like yourself who report on this, a greater level of comfort that what we have done, we have done very appropriately. And we have met our obligations and what this will do is to ensure that we continue to meet those obligations, not to necessarily improve or just to continue. It is to make sure that there is that level of transparency and clarity and removal of ambiguities that I think sometimes is reflected in some of the reporting on our supervisory function, the way we manage conflicts and our role in the whole regulatory framework.

And the final issues really go to on the communication issue, how we communicate to the market. The substantive issues are not really there to be questioned and the settlement process I have outlined to you - the settlement initiatives we did post-Tricom. So when I go through each of the 10 recommendations, yes they are recommendations, but they are essentially just refinements and enhancements of what we currently do which ASIC really is at pains to say is adequate.; It meets the test and they have not found any incidents, certainly in relation to conflicts or any incidents in the way we supervise the market, that warrants any other more substantive need to improve the way in which we supervise the market.

In the report it says that at the time of its site visit in late 2007 ASIC was concerned there might not be enough staff, there might be potential staffing shortages in the surveillance and enforcement unit, what do you say to that?

Eric Mayne:
Yes they made that observation at the time of the assessment visit in November. Let's deal with each of them in turn. In relation to surveillance they made the observation that there was increased market volatility and therefore there was an increase in the number of price alerts we would have to handle and therefore they identified that that was an area of possible need for increased resources. They didn't say we needed to inject resources at that time, they said that would potentially give rise to a possible need for further resources. And we in supervision had already identified that issue and we

had gone to the board in May of 2008 and got approval for additional resources to go into that area and we had added the resources before ASIC produced its final report.

In relation to the enforcement question, that was made as an observation again. They said if we are going to bring together the ASX and SFE supervisory disciplinary processes that means that the unit that currently handles just ASX disciplinary matters will also have to handle SFE disciplinary matters, and therefore there will be a need to inject further resources there. They didn't start to commence operations until 31 March. And again in May, the subsidiary board approved the injection of an additional resource in enforcement to make sure that resources are available to deal with that increased needs. So yes, they identified just those two areas.

The other point I would make in addition to that is we injected another six resources into other parts of supervision because we felt there was a need due to potential trends in the way in which areas were developing. Notwithstanding that we have added resources into Perth, Melbourne and Sydney just to deal with listings in anticipation of the increased listings workload that we might have when the new project AQUA comes on board. So again, we are anticipating that we need those resources and the subsidiary board has been quite responsive to my requests for where I have been able to identify the need for additional resources. The monitoring tools that we have in place have been a very effective tool in making sure that we are making timely requests and getting timely responses from the subsidiary board and also the main board.

Just to clarify, did you go to the board in May 2007 or May 2008?

Eric Mayne:
May 2008 is when I got approval to get a budgeted increase for eight resources into Financial Year 09, but I already had increased the headcount by five without getting approval.

OK thanks.

Eric Johnston, Australian Financial Review
Just again, initially on the issue about the liquidity for the stockbrokers, I think that the feeling is out there that the stockbrokers agree that there should be some increase but it's the rapid pace and the quantum particularly in this market which is going to send some out of the market perhaps unnecessarily. Is there some sort of flexibility around that total number and time table?

Robert Elstone:
I think we should just be clear about your use of 'out of the market'. I mean the notion that we have done something which is going to send brokers broke or cause them to cease existence is not accurate. There are other alternatives that are available to brokers and the reason we phased in the uplift was to have the very dialogue with the parties that are affected that we are currently having. So at the end of the day I think that is probably all we can say, but I think this notion that there are a very large number of parties affected and they are all going to go broke is simply grossly misleading. We are in dialogue and we will stay in dialogue, and we will be doing whatever we can to understand their issues and resolve their issues.

Well just on that also there is strong commentary from the ASX about directing some into third-party providers, is it wise to have a concentration of that clearing facility in this market?

Robert Elstone:
The issue of concentration of clearing risk is both an absolute one Eric and a relative one. There is already such a degree of diversity in equity market clearing that to add a bit of concentration does not, in our view, open up systemic risks either to our clearing houses or to the wider financial system. The real issue is that we have taken the view that the current minimum capital requirement, that hasn't changed for over a decade, and given subsequent events, is simply not appropriate as a minimum capital requirement and that has to be lifted and people have to be given sufficient time. We have given them 18 months, and we are in dialogue to see what other avenues may be open to them to meet our requirements.

And just one quick one, off the market a bit but I noticed in the financial year to date activity, equity or cash market volumes are increasing but the futures volumes are going down, what is going on there?

Robert Elstone:
That's largely been the trend for the last 4 or 5 months. Essentially I think it goes to my opening remarks which is the global de-leveraging that is occurring in credit markets is clearly having a disproportionate impact on fixed income markets. So if you look at the makeup of our futures market volumes it is largely the medium and long-term bond contracts where volumes are going backwards mainly because we have seen a complete drying up of the corporate debt market in Australia and a complete closure of the assets securitisation market in Australia in the past 12 months. So the two markets that provide the primary mechanism or demand curve for interest rate futures have been asleep for 10 or 12 months. In fact, I would argue that our futures volumes have held up incredibly well because if you back out the last year they are well up on the prior period. So I would have been very, very surprised if our futures volumes had not fallen given the fact that two of the lead indicator markets have effectively been closed.

John Durie, The Australian
I know this was asked at the analysts conference but I guess I will get the same sort of answer, but you made some reference in the annual report to offshore markets for customer acquisition so there is some sort of expansion there and you have been talking about this for 2 or 3 years and we haven't seen a lot of evidence of this. Are you in any active talks with anyone at the moment?

Robert Elstone:
I wouldn't tell you even if I was John and I haven't been talking about it for 2 or 3 years, you have been asking me the question for 2 or 3 years John and full marks to you for asking me the question. I always feel under pressure in anticipation of your questions to say something and that's why I have said what I have said. Whenever we are in active talks we will inform the market when active talks become an actual transaction.

I am more interested in whether you think it actually would add value into the ASX.

Robert Elstone:
I am not hedging your question John, it's an impossible question to answer because it would depend who it was, it would depend upon the terms, it would depend upon the industrial logic underpinning the combination. There are certain exchanges out there that prima facie it could make some sense for us to co-operate with or combine with, but I am not going to name them and I am not going to tell the market who they are and when we might be talking to them. It's a permanent ongoing process. The fact that we haven't announced doesn't mean that we keep trying and failing.

A quick one for Eric, I am just confused on Tricom. You say things are being wrapped up but I am not aware of any disciplinary action against Tricom which I would have thought something might be flying there.

Eric Mayne:
The disciplinary action, the process itself, does take time and not surprisingly there would be potentially some complex issues involved in looking at making sure they have complied with that. As a rule of thumb, if we were to from the time of identification of a potential breach to have the matter brought to conclusion before a disciplinary tribunal, assuming there was no real hiccup and assuming that the participant agreed that what we were asserting was right and going through that process to final conclusion, that would take a minimum of 6 months. And we are not talking here in relation to issues that might be just a relatively clean skin disciplinary action. All I can say is as we do with all areas where there is potential for rule breaches, we investigate them with all due diligence and prosecute them with as much rigour and timeliness as we possibly can. If there is a matter that comes out of the Tricom in terms of disciplinary action it will surface, whether it is going to be this calendar year or early next year I can't tell you. I am not in a position to tell you where that is at this moment but I can just say that if we are, you can be assured that it will be prosecuted with due vigour.

One final question, ASIC have sort of re-arranged their surveillance areas to bring them much closer to market, I think they are in effect duplicating what you guys are doing and I am just wondering whether you think that is a good idea?

Eric Mayne:
I don't think they are actually duplicating what we are doing. If you go back to what the chairman of ASIC said at the SDIA conference when he made the announcement about injecting resources, they

are really there to provide additional resources to make sure that we together get a more timely outcome in terms of investigating the things around market manipulation and insider trading. The chairman is injecting additional resources to make sure he is in a position to deal with the additional referrals we might give to him and also to be able to respond in a more timely way, so he is looking for a much quicker outcome and I see that's what he is doing. To the extent that there may be duplication, then that can only be a good thing and it's not inconsistent with what other statutory regulators have overseas. You will find the SEC have their own market surveillance unit and quite a substantial one to replicate what the New York Stock Exchange has and you will find that is a feature around the world. So on one view, ASIC may well be just playing catch-up.

Which is why I don't understand why you are so concerned about what might happen if there are new exchange operators.

Eric Mayne:
No one said that I was concerned.

Well I think you have, haven't you, you have raised a lot of issues about that.

Robert Elstone:
Well I think John, it's Rob again, the issues we have raised go to approval requisite to the granting of the licenses and that the government needs to form a view on what the regulatory framework should be as it relates to market supervision. There are a number of alternative routes it can take and that's the issue for government.

Elizabeth Knight, Sydney Morning Herald
Hi Robert, I just wanted to get a bit of colour around your cautious optimism about the ASX outlook. Obviously this is a result that has seen a 16.9% increase year-on-year but a 2.7% half-on-half, are you cautiously optimistic that you can retain those sorts of year-on-year growth rates with all these new products in this sort of environment, or are you just cautiously optimistic that you can do slightly better than nothing?

Robert Elstone:
What was behind my comment, and I was, at pains to point this out to the analysts this morning, is that when I use the words cautiously optimistic I am cross-referring there to very much a medium-term view of the outlook for ASX based on the investments we continue to make in supervision, in our technology platforms, in new products and in new service innovation. And really by inference, Elizabeth, what I am saying is I don't know and you don't know and the best economists don't know whether the sentiment over the next 12 months is going to stay as it was in the last 12 months or whether there will be a further downturn or an up tick.

So when you say you are cautiously optimistic, it's a medium- term thing but at the moment if the market stays as it is, well if the values stay low, the volumes may or may not stay as high as they are, can you improve in the 6 months that we are in or the 6 months thereafter?

Robert Elstone:
Yes we can but I am not making a forward looking statement about the extent to which it will improve.

Right, so it can move ahead but I would assume obviously not at the rates that you just took.

Robert Elstone:
Yes you are spot on.

The other question if I could would be for Eric. Going to market supervision highlights you have got a million or thereabouts imposed in fines and another $280,000 imposed for SFE business conduct and market practices. How much does it cost to run your market supervision division in a year? These would be yearly figures would they not?

Eric Mayne:
I can't answer the question in terms of the cost of market supervision. We do not as a matter of practice disclose what the dollar sum is. ASIC make an assessment about whether or not we have adequate financial and resourcing arrangements and they did do that in the assessment and they expressed the increase in spend in each of the years in percentage terms and we provide them with

details of what the dollar sums might be, but it is not something that as a practice we would release to the market and we don't find any utility in doing that.

In relation to the disciplinary tribunal function, again what we do with the cost of running the tribunal in terms of the external fees we pay to members and also the external legal fees, that is funded out of the fines that we recover and the balance is put to education and research. So out of the $1.3 million for example, you will see at least $800,000-plus that would be put into education and research over the financial year for 08-09, for this current financial year.

The one just past?

Yes correct, or the details that I gave you was the revenue that we generated in the last financial year and we then spend in the next, i.e in the current financial year.

Julian Bajkowski, Australian Financial Review.
Earlier today in the analysts briefing you said that there were no plans to sort of go through any major platform overhaul for the technology that you are using for about two years but I am just looking at the ASIC assessment and its noted that the SYCOM is running about a year late. I was just wondering if you could give us some colour around what the problems are that are affecting that and how that is factored into your plans to keep your technology up to date.

Robert Elstone:
The SYCOM upgrade that is referenced, in fact there are two upgrades. Both are referenced in the ASIC report. We are doing an upgrade in the fourth quarter of this calendar year of the existing platform for both capacity reasons and other technical reasons. Over and above, that my section of the annual report we released today also alluded to the intention to migrate to a new platform in the financial year 2010, so that's the year beginning 1 July next year through to 30 June, so there are two upgrades. One which is imminent for capacity reasons and one which will effectively take us onto a new platform in about 2 year's time.

Is that just for SYCOM or is that across the board?

Robert Elstone:
No that's just for SYCOM. We did an equities platform capacity upgrade last April just gone and we are doing another one in the first quarter of 2009, so we will probably do capacity upgrades about every other year on both platforms.

And the external review that's been put in place, what bearing does that have on the upgrade; I mean does that have the power to stop the upgrade?

Robert Elstone:
Quite the reverse Julian. The agreed action that's in the ASIC report is so that ASIC can get visibility that the governance process that we wrap around the project management of either a capacity upgrade to an existing platform or a change-out of that platform to a next generation platform are adequate so that we are minimising or mitigating the project risk of these large project change-outs.

I mean it's not that large - $10 million - why is it a year late?

Robert Elstone:
The upgrade that's late is the one that is due later this year and that has got nothing at all to do with the $10 million you are quoting which is on the actual generational upgrade in two years time. The reason for the delay is primarily that we have very high standards in terms of software quality and we have not been satisfied with the quality of the software drops that we have received. We also have to observe the fact that we only have short windows to do these upgrades because of the build up in volumes that occur approaching expiry quarters in the futures market and we would never dream of doing an upgrade during an expiry period.

Andrew White, Australian Financial Review
I just wanted to ask in the ASIC assessment that was released today, it does mention some recommended changes to the ASTC settlement processes. Can you tell us what they are and whether or not this is some acknowledgement that those processes actually contributed to the settlement problems that Tricom suffered?

Robert Elstone:
They certainly didn't contribute to the settlement problems. I think the ASIC recommendations, such as they were, broadly mirrored the RBA's recommendations which Eric and I spoke to earlier. They were quite minor around lifting the settlement fail fees, having a defined window period by which settlement occurs, and the close-out process which Eric alluded to in his earlier response.

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