ASIC FORUM

SPEECH BY ASX CEO

DOMINIC STEVENS

COMPETITION IN FINANCIAL SERVICES

20 MARCH 2017

Good afternoon and thank you for the opportunity to participate at the ASIC Forum for the first time.

Today, I am here as the warm-up act to lead into a panel discussion about competition in financial services. This is a complex topic with many dimensions and opinions.

I will cover three areas in my comments before joining the distinguished panel. Firstly, some perspective on my own experiences with competition; then some general comments about the goals of competition; and finally how I see competition in financial services as it pertains to ASX.

I became CEO of ASX in August last year. So although I have dealt in markets for many years, over 90% of my working life has been outside the exchange space. Most of the financial services organisations I have worked for, or been involved with, were 'challengers'. By this I mean, fierce competitors in contestable markets, working on ways to change the system to improve things for customers and to succeed for themselves and their shareholders along the way.

I began my career in the mid-80s at Bankers Trust Australia. If ever there was a competitive culture it was at BT. We were driven to find new ways of doing things to take on those we saw as 'the incumbents'; the establishment. These were formative years and instilled in me a strong drive to be innovative and competitive in whatever I did.

The next phase of my career was spent at another 'challenger' - that being Challenger itself. Even though our main product of annuities was perceived as a conservative, old school instrument, we competed strongly to reinvigorate that market. This was tough because annuities were misunderstood and seen as an affront to Australia's equity-driven investment culture. But we saw that some balance needed to be applied to investors' portfolios, especially as they reached retirement age. I believe the competition Challenger provided over the past 10 years has added positively to the dialogue around retirement income in Australia.

More recently, I spent some time advising SocietyOne, which is an online peer-to-peer lender. It has a strong competitive desire to provide a better service to customers in a market dominated by the big banks. SocietyOne is an example among many today of a new entrant using new technology to innovate for the customer and chip away at the incumbents within our financial services ecosystem.

There's been two common themes in the examples I've mentioned. Disruption through competition; and, most importantly, an end goal of delivering a better outcome for customers.

Today, of course, I am representing ASX, which unlike my previous roles, most people would agree sits on the 'establishment' side of the ledger. This gives me an interesting perspective on how ASX competes and how it compares to other firms I have worked at.

What I can say with confidence having now worked there, is that ASX is also a strong competitor and competes across most of its businesses every day. We do not shy away from competition. We actively look at ways to improve our products and services, and we definitely do not take our customers for granted.

Before talking about my ASX experiences, I think it's worth asking: is competition the goal or is competition a way we get to the goal? … And if competition's not the goal, what is?

It's accepted that competitive markets are generally the most efficient way to allocate capital and goods and services throughout an economy. Professor Hilmer, in his seminal competition review, said "the engine which drives efficiency is free and open competition."

But as ever, the real world is not an economics textbook. There are exceptions and frictions and other factors that come into play. Reflecting this, Hilmer went on to say: "Competition policy is not about the pursuit of competition *per se*. Rather, it seeks to facilitate effective competition to promote efficiency and economic growth while accommodating situations where competition does not achieve efficiency or conflicts with other social objectives."

As such, I think it is important to understand competition within the context of the overall goal we are all trying to achieve.

While there may be many ways to define this, I think the main 'goal' must be to provide the most efficient product or service to end users. That then leads us to definitions of 'efficient' and 'end users'.

In our industry, I think an efficient service is one that not only is provided at low cost, but one that is of a certain quality, is reliable, and does not compromise financial or systemic stability. When it comes to defining end users, ASX looks at it this way: our front-line customers are the brokers, banks and traders who deal with us directly and who are our participants. We must be mindful of their needs and work hard for them. But fundamentally, the exchange is one of a number of intermediaries that exists to provide capital for companies to grow and opportunities for end user investors to build long-term wealth by taking on risks with which they are comfortable. It is by looking after the needs of these end users that we create value for ourselves and our participants.

Let me now turn to ASX. As I mentioned, competition is a fact of our daily life. To begin with an obvious example: we compete with a second venue for the trading of ASX-listed equities. Competition in this area has spurred ASX into getting closer to its customers and developing innovative new products and services for investors. It has also led to some lowering of trading costs for brokers. But it has come with the burden of increased technology, data and regulatory costs for the market. It is impossible for me to total up how these costs have affected intermediaries. However, most would agree they are quite significant and should be part of any thorough analysis of the impacts of competition.

There are additional unintended consequences of competition for end users in businesses such as these, where you strive to provide deep, liquid and efficient markets. The more a market is fragmented, the more opportunities open up to arbitrage and exploit inefficiencies. Rarely is this in the interests of end investors. In this case, ASIC deserves credit for putting in place regulatory settings in Australia that have prevented much of the predatory market behaviour that we've seen in other jurisdictions. In Australia, primacy of the long-term end investor reigns and safeguards provide a level of protection for retail. These issues must also be considered in the competitive analysis.

In addition to ASIC putting in place these regulatory settings, ASX has created new products and services to help investors manage the challenges of a fragmented marketplace. Over the last year, there has been significant growth in our Centre Point business, which is an ASX market venue which gives investors greater control over execution and reduces information leakage when trying to transact significant orders. Activity on Centre Point has grown more than 50% over the last 12 months and now represents around 10% of all on-market value traded on ASX. Centre Point did not exist prior to competition. This is a demonstration of ASX competing well to provide a solution for the end investor to the challenges of fragmentation.

One of the more exciting competitive developments over the past few years at ASX has been the increase in the listings of technology companies, particularly foreign technology companies. Here, ASX is competing domestically with unlisted options (VC, PE, trade sale), other domestic listing venues, and also at a global level with other major exchanges. And we're succeeding. In 2016, ASX listed more companies than most of our global peers, including the New York Stock Exchange, Nasdaq, Singapore, London and Toronto. In dollar terms, ASX is consistently the 6th or 7th biggest venue in terms of IPO and secondary capital raised. To put that in perspective using other global indicators - based on GDP Australia is ranked 20th in the world, by exports we are 26th and our population is outside the top 50. When it comes to raising equity capital we punch above our weight.

ASX is developing a strong capability for listing companies in the $50 to 500 million market cap range. On larger exchanges, these companies might not get noticed, will have few peers and struggle for inclusion in an index. ASX may not get the $20 billion Alibaba listing, but since January last year, we have got 9 listings from Israel, 5 from Singapore, 5 from the US and 2 from Ireland – the bulk of them technology listings. We are seeing particular interest from countries that have a vibrant small company sector, are innovative with a good governance culture, and whose domestic exchange and capital pool are modest. The size, reputation and diversity of ASX's listing market have fostered a healthy ecosystem for bringing together investors with the risk appetite to invest in companies such as these that have a growth story to tell.

These listings create benefits across the economy more broadly. When ASX attracts a company to list in Australia that company pays ASX listing fees. This has a multiplier effect, with further income generated for the lawyers and the bankers and the brokers who arrange and underwrite the transaction and who continue to service the company and trade its securities. Many of these companies set up a presence in Australia and need ongoing domestic skills to manage their listing, creating employment. In addition, by listing foreign companies – there are now more than 200 of them on ASX - we are providing product for Australian investors to get exposure to offshore markets. Importantly, ASX's critical mass has allowed Australia to compete globally for business.

To close this point, let's consider the counterfactual. If ASX was not a vibrant and competitive exchange with critical mass, not only would Australia miss the opportunity I have described, but we would be losing our own innovative companies to other exchanges and markets, taking their IP and jobs with them.

Where ASX does not have a current competitor is in its equity post-trade business. However, the Council of Financial Regulators is consulting in this area. In addition, ASX operates under a Code of Practice, which formalises the way we consult with those who connect to and use our infrastructure. The Code also gives the industry significant transparency into the revenues, operating costs and capital costs of the business. Government policy is to contemplate competition if the regulators are satisfied that the right system safeguards are in place for competition to be 'safe and effective'. This important policy goal of not increasing systemic risk or not reducing the current efficiencies achieved by netting, for example, is another area that should be considered in the competitive analysis. In the meantime, as in our other businesses, ASX is getting on and adding value for customers.

One way we do this is by providing capital to the clearing fund. It is important not to overlook this point. The clearing fund – which acts as a shock absorber to protect the whole market - holds circa

$250 million of capital reflecting its Cover 2 regulatory responsibilities. Most other global clearing houses do not provide the capital so they do not need to include the cost of that capital in pricing their fees. In these cases, the clients of the clearing house have to separately provide the funds.

ASX is also investing to improve service and functionality to its user base by looking at new technologies for the replacement of the CHESS post-trade system. When it was rolled out, CHESS was ahead of its time and has provided a premium service to its customers for two decades.

As is well known, we are exploring the possibility of distributed ledger or blockchain technology. We are in the process of working with stakeholders to find out their business requirements and with a technology vendor to test whether DLT can perform at an enterprise-grade level.

The prize here for the market, on which ASX is focussed, is to reduce the significant technology, operating and capital costs of our customers - not exclusively our own, which are quite a small part of the overall industry.

It is an investment by ASX in infrastructure that positions Australia's market for the future. To the extent that ASX does reduce its own costs, we will share these savings with our customers. As important, we believe it will provide them with greater opportunities to share expected cost savings with their customers.

ASX is not uncomfortable with the prospect of equities post-trade competition. As we've done and continue to do in other parts of our business, we will compete robustly and strive to bring innovation and efficiencies to our customers.

So, in conclusion:

1. I've discovered ASX to be – contrary to some perceptions - an organisation that competes strongly. And where it's not, it's working within regulatory guidelines that put checks and balances in place and which will allow for future competition if a safe and efficient means can be found;

2. Competition in financial services is a complex topic, the consequences of which need more careful examination than might at first be thought necessary - due to fragmentation, technology costs, systemic risk issues, and the value of scale both domestically and internationally;

3. Finally, the goal of competition is not as simple as increasing the number of service providers. The goal should be to maximise the market efficiency (cost, risk and return) for the end users, especially end investors, of financial services.

Ultimately then, the key consideration with competition – a theme I'm sure the panel will discuss shortly – is the need to put the right rules in place so that the benefits of competition can be realised and fairly distributed on the one hand, while the overarching imperatives of efficiency and stability are maintained on the other.

Thank you.