Edited Transcript of ASX HY 2012 Media Briefing

16 February 2012

Elmer Funke Kupper, ASX Managing Director and CEO:

Welcome to the ASX results presentation for the first half of the 2012 financial year. We have people joining us here in Sydney as well as over the phone. My name is Elmer Funke Kupper, I joined the ASX as Chief Executive back in October 2011 and I am joined by my colleagues Peter Hiom our Deputy CEO and Ramy Aziz our CFO.

I will present for approximately 20-25 minutes and then we will open it up for questions.

Now I'll first direct you to page three of the presentation where we have an overview of the result.

ASX delivered a sound result in what were challenging market circumstances, particularly in the second quarter of the half. Our statutory profit after tax was $175.6 million, up 2.1%. That includes a charge for some significant items of around $5 million. If we strip those out then our underlying profit after tax was $180.7 million, up 2.9% and that was driven by revenue growth of 2.8% and expense growth of 3.4%. We have maintained our policy of paying out 90% of our underlying earnings in dividends giving us a dividend per share of 92.8¢ also up 2.9%. Capital expenditure was $23 million in the half, and that, in line with guidance we gave the market earlier and all our main initiatives, including our new data centre, are on track. Our balance sheet remains very strong, giving us very good capital and liquidity positions to support our exchange activities.

These results are reflected in the profit and loss statement on the next page and if you cast your eye down the right hand side you can see that 2.8% revenue growth translated into 2.6% growth in EBITDA and 2.9% in underlying profit. We managed to keep our EBITDA margin constant at 77.8% which means our profitability has remained constant over the period. Now this result was achieved in a challenging market environment particularly in the second quarter and I thought it was important to give you a little bit of context around that.

The Global Financial Crisis started all the way back in 2008 and the first phase of that was really characterised by a liquidity crisis and, therefore, we saw once that was resolved a quite sharp V-shaped recovery. The phase we are now in is characterised by a sovereign debt crisis and that requires long term structural change to the economies in the Euro-zone. That takes longer to implement and it's much harder to convince capital markets that those reforms will bite. As a consequence, what we are seeing is changes in behaviour of both investors and participants. On the retail investor side we see a clear preference for cash and yield investments where participants have reduced the resource allocation to financial markets and have lowered their risk limits in response to the current environment. Therefore, what we tend to see is a slightly longer period of subdued activity which really started back in September/October and it's continuing to this day. We think of that more as a U-shaped profile rather than a V-shaped profile.

In this environment ASX produced 2.8% revenue growth and that was driven by growth in some businesses offsetting declines in others. If you look at it in a traditional waterfall chart on page 6, you see that the first half revenues last year were $306 million and the main decline in revenues over the half was in our listings and issuer services business. That is, of course, the business that revolves around IPOs as well as secondary capital raisings, and both were well down in the half. But that revenue decline was more than offset by strong growth in our derivatives business, as well as growth in our technical services business. I will later on comment on both of those businesses some more.

So, what we are seeing is that a diversified revenue profile works well in an environment of volatility.

Now, as I said earlier, revenue growth for the half was 2.8% but that's really the result of two very different quarters and therefore we are sharing with you today what the revenue performance was over the two quarters that make up the half. On page 7 you can see that total operating revenue growth was 2.8% but then, if you move to the right of the page, you can see that the first quarter growth was 10.9% and the second quarter growth was a declining revenue of 4.9%. So it was two very different quarters in the environment that we faced.

If you then look at the individual business lines you can see that our listings and issuer services business had a soft half across the two quarters, so in both quarters revenue declined. But in our cash market business which is around equities trading we saw a very strong growth first quarter with revenues up no less than 12%, but a much weaker second quarter with revenues down 12%. Our derivatives business delivered growth in both quarters: 30% in the first quarter, a very strong quarter, and 4% in the second quarter.

The other revenue lines that you see on page 7 - information services, technical services and Austraclear - show a much more stable profile quarter-on-quarter and that's not surprising because these are businesses that are not as dependent on general market values and volumes. I will come back to those businesses later as well.

What this page tells us is two things. First, that when there is a significant downturn in financial markets it affects the exchange business and we are seeing that in those quarterly results. At the same time, the revenue profile of ASX is an attractive revenue profile because it is well diversified and that diversification provides resilience and some cushioning when markets behave the way they have in the last six months. This diversification is illustrated on the next page where we show our revenue mix. There are a lot of numbers on this page, but the point of the page is that there are a lot of numbers, which means it is a well-diversified business. That is not unique among exchanges but the exchange model that we operate in Australia is an attractive model because we are a multi-product as well as a vertically integrated exchange and that creates this level of diversification. Where does that show up on a page like this? Well if you look at the top right hand corner you can see that listings and issuer services were 22% of our revenues in the last half, the year before that it was 25%, whereas our derivatives business was 31% of our revenues in the last half, and the year before it was 27%. So there is offsetting movements between those lines, but overall revenues went up, and that's a very attractive business model to have in the world of stock exchanges.

What I would now like to do is quickly run through each of the main businesses to share with you what has been driving the revenue performance of those businesses.

The first one to focus on is listings and issuer services. Now this is the business that provides listings, supports capital raisings by corporations and provides other issuer services, for example it sends out the holding statements when you trade in equities.

In this business, the revenues were down 12% to $68.6 million and that decline was mainly driven by a significant reduction in initial public offerings, so new listings, as well as a significant reduction in secondary capital raised. That is not surprising if you look at the bottom which shows the amount of capital that was raised over the last couple of years, really since the beginning of the Global Financial Crisis. And when you scan that chart you can see that there are some large blue bars roughly in the middle of the chart in '09 and in '10. During that period Corporate Australia raised $140 billion in 18 months to deleverage the balance sheets of those corporations and therefore it is not surprising - and by the way that $140 billion is around 10% of the entire market capitalisation of the Australian equity markets. In fact, Australia ranked number one in the world when it came to capital raised over that period, relative to its size, and therefore it is not surprising that Corporate Australia has good balance sheets today and therefore in a more recent period we have seen reduced levels of capital raising.

The second business to talk about is the cash markets, so this is about trading cash equities, and this is where all the noise is with the introduction of competition and the change in the market structure that took place back in October 2011.

Our cash markets business consists of three components: the trading activity and the fees we get out of that, as well as the clearing and settlement of those trades. Overall our revenue from cash markets was stable at $66.9 million but as I said before that is really the outcome over the half. The first quarter was much stronger than the second quarter as trading volumes declined significantly after rising in the first quarter.

What is pleasing is that our trading revenue overall has been stable over the half despite having a reduction in the amount of market activity over the half. And that's a function of higher average fees that we have been able to extract from this business, because we have been able to grow some new order types that attract higher fees and we have also seen lower crossings, and this is basically where larger trades get done outside of the normal market by large institution investors. If there is less activity by institution investors there is lower crossings, and those things have helped the average fees, but of course they don't help volume.

Other than that, what we have seen in equities trading in Australia in recent times has continued. We are seeing continued growth in the number of trades - and in fact in the first half the number of trades on the equity markets was up 24% to 87 million. The average trade size is going down, so we see more trades but the average size is down and so overall that actually creates a flat result. That is really a characteristic of the change in investor and trading behaviour that we have seen elsewhere in the world and the change that we are seeing here in Australia.

And, of course, in October 2011 the environment in Australia changed and competition was introduced in the equity markets. Now that was in October 2011 and standing here in February 2012 it's too early to assess the impact on the exchange and the overall market because it's only been a few months. But on page 11 we make a couple of observations about the introduction of competition and change in the market structure. The first is that the impact on ASX is relatively limited as a result of our business model, in other words in the first half the revenue from equities trading was 6% of the group revenues and therefore the market structure impacts on that 6% and not on the rest of our business.

We have been preparing for the change in market structure for some 18 months now. We have introduced a number of new products for our clients to operate in that new multi-exchange environment, and we are learning a lot right now about how those products are working for us. We will continue to be very nimble and respond to any changes that we see in customer behaviour and regulations.

The third thing I would like to highlight is a change in market structure doesn't just impact on us; it also impacts on all participants that operate in the marketplace. And this is quite important because the consequences of the introduction of a new market structure are not all positive. The new structure in Australia facilitates high frequency trading, in fact we would predict that the main growth we will see coming out of the new market structure is in high frequency trading.

Now fund managers who traditionally execute through the normal markets, which we call the lit markets - this is where transparent price formation takes place - those fund managers in a world of high frequency trading want to take greater control over the execution of their investment decisions and as a result they are increasingly attracted to what we call dark pools. A dark pool is nothing more than shares being exchanged outside of the normal market in darkness, where people can be anonymous and not to disclose the volumes that they are willing to trade, and we will continue to see growth in dark pools in Australia as a result.

There is also an impact on brokers. On the one hand, brokers benefit from lower exchange fees and product innovation but, on the other hand, brokers face much higher technology costs as they need to be ready for this new multi-market structure and they face higher compliance costs and it's not yet certain where that will land. We believe that the outcome will be negative for many smaller brokers who cannot compete in the new world of higher frequency trading that demands higher compliance costs and higher technology costs.

And then finally, the new market structure creates a real challenge for regulators and governments to ensure that as things settle down that the normal lit market - this is the exchange that is so critical for capital formation that during the Global Financial Crisis raised $140 billion dollars over 18 months - that that market continues to be the dominant market for trading and capital formation. So far regulators, predominantly ASIC, have taken a sensible approach to this, but we believe that there are still some regulations to be put in place to make sure that that continues to be the case and that we do not go the direction that we have seen in America and Europe.

Now while we continue to make the arguments around regulation and the multi-market environment, we will also get on and run our business. While the new environment creates risks to some of our revenue lines, even if it is only 6%, it also provides opportunities and on page 12 we share some of that with you. The new market environment opens up opportunities to offer new services to customers who need to be able to execute in that environment, an environment that requires more sophisticated technology and significantly higher speeds. ASX has invested in our technical services business to make sure that it can create new revenues out of offering those kinds of services, and you see some of the impact of that in the first half. In the first half our revenues from providing those kinds of services increased by 19% to $22.6 million. That is strong growth and it tells us that the new market structure is not just about competition and lower fees, it is also about new opportunities that give us new growth as we offer new services.

Another business that is closely related to equities trading is information services. This is the business that provides data to investors, both retail and professional, that allows them to develop and implement their trading strategies. In the first half we have seen a small decline in those revenues as retail investors stepped out of the market and, of course, reduced their use of data as well.

So when we think about the cash markets we don't just think about competition by a new exchange and the impact it has on our revenues, we are thinking about our aggregate revenues. As much as there is risk to some, there is real opportunity in others and these results start to show that that is starting to work for us.

The next business to quickly focus on is our derivatives business. Our derivatives business is now 31% of the company, it is the largest business in the group and in the first half that business performed well with revenue growth of 17% to $96.6 million. That was all driven by one part of our derivatives business, our futures business, where we saw very strong volume growth and also we paid away some lower rebates compared to the previous year. That business performed very well. There is another part to our derivatives business which we call ASX derivatives which deals with exchange rate options and index options. That business did not see revenue growth, in fact it saw a small decline in revenues of 2% despite volumes growing very quickly. And so in that business we have seen a shift in the way that volume is produced, we see a big increase in the market-maker activity and there are some challenges in making sure that the fees for that business are set correctly, and so we will look at that. Overall this is a pleasing result with strong volume growth and strong revenue growth from our derivatives business.

The final business to briefly discuss is Austraclear. Now Austraclear is the central safe-keeping facility in Australia for fixed income securities, and that business continues to perform very well. If you look at the bottom chart on the page you can see the red bars going up very, very steadily and you see the blue line going up very, very steadily and what that tells us is that both holding balances and transaction volumes in fixed income securities continue to grow. That means that Austraclear as the safe keeping facility continues to grow as well, so revenues in this business are up 5% during the half.

Now, other than providing products for market activity, ASX also earns interest from dividends, income from dividends and interest, and we summarise those results on page 15. Overall interest and dividend income was up 13.7% in the half and that's completely driven by an increase in the amount of collateral we hold in our clearing house from participants and a slightly higher spread that we were able to earn on that collateral. If you do both at the same time you can get double digit revenue growth in interest income, so that has been an attractive part of our business over the last six months.

There is a lot going on in the exchange world, and there is increasing complexity, and we are responding to that by having quite a wide range of initiatives to continue to improve our business model and be ready for changes in market structure and on pages 16 and 17 we summarise those. Now I am not going to run through all of those because there's a lot of detail here but I will make a couple of observations about each of our main businesses.

First in listings and issuer services - this is all about listing corporations and helping them raise capital and providing other issuer services. We have got three big groupings of initiatives here. The first is to make sure Australia continues to be an attractive country to list and raise capital. We have done very well in Australia and we have some 2200 listed entities. We have done very well during the Global Financial Crisis and we think there is more to do to make sure we stay competitive as a country to list and raise capital.

In addition, there is a number of product development initiatives. The one that has received some attention in the media in recent months is in Commonwealth Government securities and we are still hopeful, on the back of a Government commitment to develop a corporate bond market, that we will be able to list Government securities for the retail market later this year.

Finally, we see a real opportunity to streamline the processes around investing in managed funds. Currently if investors want to invest in unlisted managed funds there is a very cumbersome process that goes with it, an application that is paper-based and a redemption process if people want to sell their investments that's paper-based as well. We in Australia have terrific technology to automate and streamline those processes and we have started an initiative to see if we can work with others in the industry, both distributors and managed fund operators, to see if we can automate and streamline that entire process which we think will increase the distribution of managed funds, because it is easier for investors, and at the same time takes an enormous amount of paper out of that process.

Then as we go down the page we move to our cash market trading technical services and information services business. Now we group these together because, as I said earlier, as the world changes in equities trading we need to evolve our trading platforms, we need to build our technical services business and we need to think differently about how we offer information and data to different customer groupings, be they high frequency traders down to retail investors. So we think of these together.

In that space we have a large number of initiatives in response to the change in market structure; we have launched a number of new trading vehicles and products for investors, particularly professional investors and high frequency traders. We have taken a portfolio approach by launching a range of new offers and we are currently looking at what is working for us and what is not working for us. And not everything is working, while other things are working better for us. We have launched a product called VolumeMatch - it hasn't been working well for us so we are in the process of redesigning it. We have launched something called CentrePoint which is working better for us than we expected, and another product PureMatch - which is a high frequency trading platform - is still in pilot. And what that tells you is that we take a very proactive approach to responding to change in market structure and to the needs of different segments and we will continue to be very fast on our feet to make sure that we are successful in this business.

At the same time we are launching a whole new range of services to connect investors and traders to different markets and allowing them to execute in this new world of a multi-market, and that's what we call technical services and that business has been growing 19% in the first half. When we look at these three revenue lines we look at them together and our strategy is to make sure that together they continue to grow even if there is pressure on one there is opportunities in others, and the first half shows that has been working for us.

And then we move on to the cash market clearing and settlement. So this is the back-end of trading activity where we clear the trades and we settle the trades. Again, we are responding to change in the market structure by doing some things that adjust to that, and we are doing quite a bit of work to improve the capital efficiency and collateral management because these clearing houses require capital, they take collateral from participants. Those numbers tend to be increasing as regulations change and we need to make sure that we continue to work to offer the most efficient use of capital and collateral for our clients in those clearing houses.

And then finally our derivatives business, which has been performing very well in the first half. We have a number of new products that we will be launching this year and next year and we are doing some work to improve, again, the way our clearing operations work. Finally, in derivatives we see an opportunity in clearing of over-the-counter derivatives, so these are Australian dollar interest rate swaps which are currently not cleared through an exchange and Australia, as part of the G20 commitment, has agreed to make sure that that product does get cleared through an exchange. So we are waiting for the regulatory framework around that to see if there is an opportunity for us.

So there is a lot going on for us, not only to respond to changes in market structure, but at the same time make sure that we can continue to grow the core parts of our business where we have a very strong position.

All of that requires investment and it's pleasing that in a period of investment the company managed to continue with its sort of traditional expense disciplines and, on page 18, we give an overview of our expense growth. Total expense growth - roughly in the middle of the page - is up 3.4%, and that growth was really driven by three things: the normal increases in staff remuneration with staffing levels being relatively stable at around 500 - and I should say that to run an entire multi-product and integrated exchange with 500 people is extraordinary. It's something that I inherited from my predecessor and it's been very well managed over recent years.

The second increase is in occupancy costs. We have launched a new data centre that is operating today, it is operating successfully but of course that means occupancy costs go up.

And finally supervision costs are up, which is the levy that we get from ASIC as other participants in the market get a levy as well.

Those expenses are all driven by initiatives and things that we have done to the business, all other discretionary expenses have been very well managed to contain growth to 3.4%. Now given that there is so much going on we gave the market some guidance today around expense growth and we said that we expect expense growth to be in about the 4-to-4.5% range for the full year.

There were no surprises in capital expenditure. Capital expenditure for the half was $22.6 million, that's in line with the guidance we gave the market earlier. If you look at this page you see the bigger green part on the chart, that is new data centre, that data centre was opened in February after an initial delay. As you know we had an outage last October which forced us to do that. It is operating successfully today and we will finish that project this half. And we have given the market some guidance as well today around the overall capital expenditure for the year, $35-$40 million as well as a depreciation and amortisation charges.

Finally, ASX continues to have a very strong balance sheet and capital and liquidity position. Now this matters a lot in today's world where exchanges operate clearing houses and settlement facilities. They need to be supported by capital and liquidity, and our exchange continues to do that conservatively and well and therefore we haven't seen a lot of movement over the year in those positions. On the left hand side of this charge you see the dark blue bar is materially above the other two, which suggests that we have a healthy level of non-attributable capital - capital available to support the business - and on the right hand side you can see that we have an attractive cash surplus as well, so again from liquidity and capital position, the clearing house continues to serve the Australian market very well.

I would like to finish by briefly looking forward.

Our business is very much driven by corporate activity and market sentiment and confidence and both remain subdued in January and early February as we are all waiting for the European debt crisis to run its course. We have seen a gradual stabilisation of the monetary union and that is a good thing, but at the same time we continue to see significant uncertainty whether the Euro-zone will actually deal with the debt problems that it faces and whether the measures that it's taken will actually bite. And as I said in my introduction those structural reforms take longer to implement and it's harder to convince capital markets. As a consequence we also believe the Euro-zone will face a recession this calendar year.

On a positive note, the US economy is showing signs of recovery and we believe that the US economy will start to climb out of the depths that it has seen in recent years. Australia continues to be relatively well placed in this but, of course, these global events do have an impact and we are seeing pressure on bank balance sheets, corporate earnings and productivity. That is the environment in which markets live today, and that is what we are seeing in the early part of the second half. So we have had a slow start to January and we have seen some improvement in the first two weeks of February, so over those six weeks that include January and the early part of February cash market trading volumes were still down, about 9% year-on-year and derivatives volumes were flat year-on-year. What is encouraging is that the first weeks of February were much better than the lows of January. But the reason we don't give an outlook statement here for the remainder of the year or beyond that is that it is very hard to read where that will go in the next couple of months.

For our company it is important that we continue to be disciplined on the expense line and at the same time invest in areas where we can see growth when market confidence returns, which of course one day it will. Let me close by giving another summary of the results.

ASX produced a sound result in quite challenging market circumstances, particularly in the second quarter. Underlying profit after tax was up 2.9% to $180.7 million, driven by revenue growth of 2.8%, expense growth of 3.4%. That allows us to also increase our interim dividend by 2.9%. Our initiatives are broadly on track and the new data centre is now open for business and operating successfully. We maintain a very strong balance sheet which allows us to manage the risks in the exchange, but at the same time make the investments that we need to make to ensure we can grow when market confidence returns, which of course it will.

This is where I will stop presenting and open it up for questions that you might have here or in Melbourne over the phone.

Shani Raja, Dow Jones:

You mentioned that listings revenue had a big decline. What do you see as the future of listings revenues? You put it in historical context after the Global Financial Crisis, but where does it go from here and is that totally dependent on the Europe situation or are there any other dynamics that we have to consider?

Elmer Funke Kupper, ASX Managing Director and CEO:

I think there are a couple of things. If you look at page 9 of the presentation you can see that these numbers tend to be quite volatile of course as you go through economic cycles, and so we have had a period for about 18 months back in the 09/10 financial year, where numbers were very, very high and of course people use that period to de-lever the balance sheets of corporate Australia. So that was an extraordinary period of capital raising so it's quite natural to see a reduction for a period of time after that. I think we will continue to have very, very healthy capital markets here that perform very, very well. So as the world recovers and corporations see opportunity for investment that requires capital, they will come to the market and at the same time as there is corporate activity, acquisitions and M&A activity then we will see that recover as well. So we are not particularly worried about this, as this is the state of the economy, and that will recover provided Australia continues to be an attractive place to raise money and list, and we share with you some of the initiatives that we are looking at just to improve that sum further. But we are not concerned about this, just a sign of the times.

Shani Raja, Dow Jones:

With regard to competition and the change in the market structure, do you expect there to be more competitors coming into the market and is that what you are planning for? Or can the market not support any more?

Elmer Funke Kupper, ASX Managing Director and CEO:

It's actually not for me to decide, is it? I mean this is about governments, regulators and others who look at our market as either attractive or unattractive. I think we are well placed in the current competitive environment. If you look at cash equities trading, this is a very interesting phenomenon: so we have created competition, we now have two exchanges, that affects 6% of our revenues and yes we have reduced our exchange fees, but if you step back from it you actually wonder what we've actually done here. Because remember there is a couple of things about that market structure that we might one day regret, and when I say "we", I mean Australia.

The first is that the new market structure puts enormous pressure on the smaller brokers, but in order to compete in this world you need to make serious investments in technology and resources and you need to be able to cover a higher compliance cost that comes with greater complexity. And that's not criticism it's simply the fact of the way these markets operate. And so smaller brokers were already under pressure, and of course the GFC added to that, and now this new market structure I don't think helps them. So I think this puts pressure on the smaller brokers. I think we will see more consolidation in that market, and that was probably always going to happen, but I think that these kinds of changes don't help them. We have not yet quite seen that play out but I can see a scenario where that really happens.

I think the second thing that we might regret is in a multi-market environment, where we have high frequency trading, you have massive concentration in the broker world, you will see an increase in the amount of trading that takes place off-market where brokers basically cross individual transactions off their client base on opposite sides and then report a net result to the market. And if you take that to extremes you can see a reduction in lit market activity, which is the market that we all see, and a significant increase in the market outside of that which is unlicensed, largely unregulated and predominantly dark. And while we believe that dark pools and dark markets play a role, particularly for very large transactions that might move markets - so large block transactions can be transactions outside the market, I think we have to be very, very careful that we don't see that shift increase too far. Because remember the lit market is the market that we all rely on during the times of the Global Financial Crisis. It is absolutely critical to the country, not just to us.

Now that story about dark markets and things moving away from lit markets has got nothing to do with Chi-X and ourselves. Chi-X is a lit market, we are a lit market, we are both lit markets but the consequence of the new market structure is that with the introduction of high frequency traders, traditional investors - particularly funds managers - look at that and say: "I am not quite sure that I like being outgunned by high frequency traders every time I want to buy 1% or 2% of a company or sell 1% or 2%, I prefer it to be on the side and be in a dark environment". Now to some degree that's natural, and there is a role for that, there has always been a role for that, but I think we have to be careful not letting that go too far. And there are some very simple measures that regulators can put in place to manage that. I think so far ASIC, which is the main regulator, has been very sensible, to manage this. We have argued very strongly, and again that was in the media this week that there is one or two things that need to be done, and they need to be done now, to make sure that we keep this on the right hand side.

We don't have a problem today, things are working just fine, but we all know with markets that they can move very, very quickly and I believe is it is better to regulate a bit early and manage that risk.

So that's a long story to say these movements are real, it doesn't impact our business all that materially, but it might impact on capital markets over time.

Andrew White, Australian Financial Review:

Isn't there a contradiction in setting up the business to encourage high frequency trading and complaining that all the fund managers are moving their business to the dark pools?

Elmer Funke Kupper, ASX Managing Director and CEO:

This is the sad reality of being in a commercial business where you don't set the rules. We don't determine the rules. We have to live within the rules, we give feedback on the rules and we try to influence the rules but we don't determine them. Our job is to be successful, and we are successful, within those. And so the reality is the growth, the advent of technology and a multi-market structure create an environment where that's where the opportunity is. Our job is to capitalise on the opportunity just like everybody else, and that's what we are doing. And this is the reality of markets you know that are regulated. It's the regulators who set the rules, we play within that. Hopefully they also listen to us when it comes to some of the dangers of those changes and those changes are not visible today. Today things are fine, but we are just saying we want to make sure that we sit on the right side of this, and in the meantime our job is to be successful. And you can see in those revenue lines that we are.

Andrew White, Australian Financial Review:
Is that to say that keeping the fund managers in the lit market will be more a case of regulatory stick rather than a carrot for them to stay there?

Elmer Funke Kupper, ASX Managing Director and CEO:
I think fund managers do transact substantially to lit markets and there are some rules in Australia already that allow them to trade outside of the market for larger block transactions. What we are talking here is that over time those thresholds will come down and down and down and down, until you can start transacting retail transactions off-market. And if at the same time brokers are consolidating where they get more and more of the customer flow, you can imagine an extreme situation - which of course sounds a bit like a silly example - where you have you know four or five brokers who cross everything off-market and report the net result to the market and the lit markets sort of reduce materially. You know that is not going to happen. But what we are saying is regulators need to make sure that we put some rules in place early, and early means now, that keep us on the right side of that. We are not talking about this year or even next year, we are talking about longer term trends but I think the Europeans and Americans have discovered that if you keep watching it, one day you want to try and backtrack and backtracking regulations when markets have moved is actually relatively difficult. Because, of course, when you have to backtrack, it will affect people who have been successful from those changes. And that is just as difficult as putting them in place early. So we say put them in place early, be done with it, and you don't have to worry about it. And I think in Europe, the noise you hear is I think, a consequence of not acting early enough and now having to backtrack which creates all sorts of problems in its own right.

Andrew White, Australian Financial Review:
Is there any sense that these developments are affecting or discouraging companies from wanting to use the ASX or other markets to raise capital and to list?

Elmer Funke Kupper, ASX Managing Director and CEO:
No. No you need to get to very extreme outcomes, which we are not seeing anywhere really, for that to be the case. So we don't have a problem at all with capital formation today or the attractions of the ASX to list or not to list or large markets around the world to list. And so these are longer term trends, and our argument is only to make sure that we regulate early and now. Again, ASIC has actually been very sensible to date. I mean we are encouraged with the way they are thinking about it, we just also encourage them to perhaps in one or two areas act early enough.

Andrew White, Australian Financial Review:

The other thing is, what do you see is behind the growth in the derivatives business and is it a structural shift in the business that derivatives will be the dominant revenue engine for the ASX?

Elmer Funke Kupper, ASX Managing Director and CEO:
That's a question I might ask Peter Hiom our Deputy CEO to answer.

Peter Hiom, ASX Deputy CEO
I don't think it's anything particularly profound. I think we had a lot of volatility in the first half of the year, particularly in the first quarter as you saw through the numbers so we see that translate into higher activity levels in interest rate and equity hedging. We have done a number of things to stimulate liquidity in the equity options market which have been successful in growing volumes but not revenue for us. I don't think it's particularly indicative though of any shift, rather I think it just underpins the value of a vertically integrated multi-asset class exchange group. You get these ebbs and flows where derivatives become very active over a period of time of extreme volatility, and at other times of the cycle you see a lot more capital raising, for example, which would be almost in the off-cycle of the derivative volatility.

Elmer Funke Kupper, ASX Managing Director and CEO:
If there are no more questions here in Sydney I might open it up for questions over the phone.

Malcolm Maiden of Fairfax Media:
The Singapore / ASX merger was being discussed at a time when there were mergers afoot across the globe. Things have changed a little bit, and I am just wondering if you can give us a bit of a summary of how you are seeing the situation now and what your strategic setting is in terms of global industry rationalisation?

Elmer Funke Kupper, ASX Managing Director and CEO:
I won't comment on our strategic setting because of course I can't but what we have seen over the last few years is several attempts at cross border exchange mergers which I think without exception have been rejected for different reasons: some good reasons, some not so good reasons. And so, most recently the New York Stock Exchange and the German Exchange have tried to merge, that was rejected by the Competition Commission in Europe. We had the London Stock Exchange and Toronto make an attempt and Singapore and ASX make an attempt. So, irrespective of whether these things fail or succeed, I think what it tells you is that we will continue to see, I think, attempts in the world to bring exchanges together as scale and global reach continue to be important. What we can't predict, of course, is who will do what and whether they will succeed or not. So right now I am watching it and I know there is nothing to talk about and we won't comment on it. But I don't think it is going to go away simply because some other rationale that sits behind it is as valid today as it was, you know, two or three years ago. And so we will be keeping a very close eye on what's going on in the world there, recognising that perhaps it's going slower than many people in the exchange would have liked, simply because it's hard to overcome either the nationalistic, political or competition hurdles.

Nathan Lynch of Thompson Reuters:
Just a related question to that, with the Council of Financial Regulators review of clearing and settlement, what impact do you expect that to have on the business are you following that pretty closely?

Elmer Funke Kupper, ASX Managing Director and CEO:

Well, of course, this is the review that thinks about what we need to do with systemically important infrastructure, and what rights should the regulators - particularly the Reserve Bank - have to manage that if something goes wrong. We think that is an absolutely critical question that needs to be solved and things need to settle down. That is unrelated to exchange mergers; this is something that needs to be in place anyway. So the Council is reviewing the various submissions. We have, by and large, been supportive of the proposals put forward by the Council and we believe like banks and other critical financial institutions an exchange should be subject to significant oversight and rights by regulators to step in should things go materially wrong.
Now we all expect and hope that those rights are never exercised but it's quite normal to have that in place. I wasn't here, but I understand that the Singapore transaction perhaps highlighted that needed to be tidied up and we support that, with or without a transaction. It just makes more sense to us.

Nathan Lynch of Thompson Reuters:
And you have mentioned the growing compliance costs in a competitive environment for brokers. Are you primarily referring there to best execution or are there other things that they are needing to deal with?

Elmer Funke Kupper, ASX Managing Director and CEO:
No, no we are saying that there are two big things that they face, much higher technology costs if you really want to compete in that new world of fragmentation as we call it, but at the same time we have transferred activities to ASIC which is the natural thing to do in this environment and so the costs of ASIC operating that more complex environment are now of course coming back to the industry: the exchanges – Chi-X and ourselves - but also the participants who trade and they are getting the bill for the structure in some ways they have asked for. And so these are real consequences, they are hard consequences and I think for smaller brokers perhaps difficult to absorb at this time.

Nathan Lynch of Thompson Reuters:
So looking forward then do you think that execution will be an additional challenge when that obligation comes in?

Peter Hiom, ASX Deputy CEO:
I think it's already there, I mean there is, as I understand it, a drop date of 12 months after the commencement of competition where everyone must comply with the best execution obligation. So, it exists today. It falls in the bucket of increased costs. It has a technology component to it, of course, because you need a box that can actually comply, can effect the compliance, but you also have the rule framework as well. So it's just reflective of a more complex environment of which best execution is a part. That generates higher costs for users that I think the market is just grasping over these weeks and months.

Richard Gluyas, The Australian:
Two questions, you pretty heavily emphasised the word now when you are calling for regulation on dark pools. I know you said you think ASIC is doing a good job, but does that indicate a small level of frustration with the pace of reform there? That's the first one and the second one is just on the outlook. Do you expect the second half to be a bit more like the second quarter which was a bit more problematic than the first, that's what you are indicating?

Elmer Funke Kupper, ASX Managing Director and CEO:
Okay, let me not answer the second question which is around the outlook, so we don't give an outlook statement and the reason we gave a bit of detail around the first six weeks is that it's uncertainty that prevails. So a very soft

January, much improvement in the first two weeks of February, it's very hard to see where that will go and in some ways we are in that sense just waiting for the world to improve and investing in our business to be ready for that moment. I don't know when that arrives because that means I have to be able to predict the Euro-zone solving their problems and giving markets confidence that they have. So I can't make a prediction about that and I won't. When it comes to the regulation I think this is partially a judgement call and a matter of opinion. I think there is no doubt in my mind that the regulations in Australia have developed well for the new environment and that the regulators understand what this is about. And in relation to putting some controls around dark pools, again there is some sensible thinking going on and some of the proposals are sensible. And the proposal that has been on the table is should there be a minimum level of trade, a minimum size of trade, before you can enter a dark pool. And so ASIC has said well we are thinking that $50,000 is a reasonable number to put in place at some stage and we are saying well we agree that will be a reasonable number but what would be the reason not to put it in place today because by the time you need to put it in place it might be a lot harder to put it in place because of the reaction you might get at that stage. And maybe this is the old risk manager in me when I was head of Risk Management for one of the major banks where sometimes you are better off doing something early. And if it's not $50,000 maybe the answer is let's make it $25,000 to start with to at least have a go at it, but surely it can't be zero. If you look what happened overseas, and this is really where the judgement call is, it's not about whether something ultimately might have to be done, it's more about a judgement call about what time do you do it. And we have been pretty vocal because we feel strongly about the lit markets in this country and the importance of those, and I think it is always easier to put regulations in and relax them later than watch it go and then try to put them in place later. That's what the Europeans have done and that doesn't seem to be working very well for them. So I prefer to go the other way. It's not up to me, but there is no secret about our view on that. It's not about frustration, it's where we are. I don't hold the cards, someone else does and we have in our submissions been very consistent. We genuinely think it is important for the country, and remember that has nothing to do with Chi-X and ourselves. I mean this is an important differentiation. That level of access to dark pools that we believe should be put in, it has nothing to do with either, because Chi-X and ASX are both lit markets: transparent, price formation and reporting to the world when the trade happens, so there is no darkness there at all.

Andrew White, Australian Financial Review:
Just on that point. In that case, the actions by the ASX have resulted in some of the funds, some of the client funds that are generally segregated by ASX as being lost or at the very best held up in the liquidation process. Are there things that the exchange could have done differently to avoid that outcome?

Elmer Funke Kupper, ASX Managing Director and CEO:
Okay, so I am not quite sure if you heard the questions about MF Global which is the market participant that collapsed overseas and then the domino effect also made them collapse here and that tied up some client funds with the clearing participant MF Global and of course with the exchange. I think there's two parts to your question. The first is: "has this been well managed by the clearing house in Australia?" I think the unambiguous answer to that is yes. It's been very well managed. The clearing house came through this exceptionally well. I think it has been in many ways managed better than in some overseas markets. Now, of course, it was also a smaller problem here so I have got some sympathy for some of our overseas colleagues. At the time of the default we held $36 million of client funds, we still hold about $34 million of those and that balance is growing with the cash market rate and so the clearing house is in a position to return the client funds that it holds.
Now the second part of your question is what happens with those client funds, because clearly they are not ours, we need to give them back. Unfortunately that is where life gets very interesting because MF Global is a large global player operating through Australia, the UK and the US so we are now faced with a situation where we have

different liquidators looking at different parts of the MF Global empire all trying to put their foot on the cash that is available and minimising any losses in MF Global should there be a shortfall. Now we have barely a shortfall and I think by the time we give the money back maybe there is no short fall at all because it keeps growing but the question is: Where does the money go? We would like it to go back of course to the clients who put it in, but this is a complex legal question because of the complexity of the MF Global structure. We are awaiting instructions and ultimately these things, you know how it goes, they can end up in court. In the meantime we are holding the balances on behalf of the participants and ultimately their clients and it is growing with cash interest and for the rest the process of liquidation will be the process.

There is an interesting point that I would like to make around this and this is around the complication of cross border clearing and settlement operations, where it all works, of course, until it doesn't. And when it doesn't you are very quickly across jurisdictional questions where a national interest might play a role or where different legal frameworks might play a role as well. So things can get very complicated very quickly. So when you think about the critical infrastructure that we need for our market we believe that should be managed here and I think MF Global is a good example of how well that can be managed and this will run its course and we have got great sympathy for the clients that sit behind it and we have worked very hard with them, and by the way with ASIC, to get that market going again. I think everybody put their shoulder to it and I think we are back up and running and I think we have done that well and we have done it well together.

Three questions very quickly over the phone and then I have to move on.

Tony Boyd, Australian Financial Review:

Elmer, are you operating under the assumption that clearing and settlement will separately be subject to competition and would you welcome that because it would seem that competition from Chi-X has benefited your customers?

Elmer Funke Kupper, ASX Managing Director and CEO:

There are two questions here. The first is competition in clearing and settlement. That is not for me to decide Tony, there are regulators and other people who have got clearing operations to decide what they do. We are working to see if we should tailor some of our clearing services for different types of clients, we call that fee unbundling. We haven't decided to implement that because I think it's too early to go down that path but we will be ready to do it. I think if you look at the Australian clearing operation and the conversation we have just had, they work exceptionally well. They are relatively efficient and particularly capital and margin collateral efficiency are really critical in this. And so if you could imagine having another clearing house where participants have to lodge two amounts of capital and two amounts of collateral it's hard to see how that would become a more efficient system from that perspective. But it's of course a model they have chosen in Europe and it will be very interesting to see how that pans out. I am not sure it is going to pan out all that well for everyone. So it's not up to me to decide, but we will live in whatever environment gets created for us. But I think it's not, if you think of what you saw with the second part is when you say it benefits our clients. As I said earlier, I think the multi-market structure in cash equities is not benefiting all of our clients, it is uncertain how it benefits large fund managers, it is uncertain how it benefits the small brokers, and it's uncertain how all that gets translated to retail customers who sit behind big retail brokers. So it's too early to tell how that will go. But if we look at the economics of the American system for example I think the two big beneficiaries of all of that have been high frequency traders and, well if you call regulators a beneficiary, the regulatory costs have gone up significantly. And I think it's hard to see how many others have benefited from it. And I think this is just a reality of how this evolves. But it is not up to us, we will live in whatever environment gets created for us but it is important that we point out that this is not all rosy and great for markets and participants because I don't think it is. But we will live within it and we are succeeding within it.

Paul Smith, Australian Financial Review:
Obviously late last year there was a rather high profile technology glitch at the ASX. Have you had to engender new processes and increased investment in technology in order to ensure this sort of thing doesn't happen again or is it just something that you have to kind of accept in a way with more technology controlling every aspect of the business?

Elmer Funke Kupper, ASX Managing Director and CEO:
Well I think it's a little bit of both. I mean we never accepted outages are a normal thing at all, but we also recognise that in very large corporations that are technology dependent they can happen and in our case they did happen. But as I said once before, I don't confuse the fact of having an issue with technology with whether the company is well managed. I believe the company is well managed and we've delayed implementation by a couple of months just to make sure we could give it the once over. So if you think of that as a change, yes that has been a change, and we opened for business in the second week of February. And so cash equities trading in Australia takes place from the new data centre and it's operating successfully so that tells us that we are good at what we do, but that also sometimes it makes sense to just slow down things a little bit and make sure you get it right and that's really all there is to it.

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