‘ASX: DEVELOPMENTS AND DIRECTION’

SPEECH FOR THE SECURITIES & DERIVATIVES INDUSTRY ASSOCIATION CONFERENCE

BY TONY D’ALOISIO
MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER

MELBOURNE, 26 MAY 2006

Summary of key points:

- ASX is committed to working together with brokers and participants to grow Australia’s capital markets. Our business interests are aligned.

- ASX understands the changes the broking industry is undergoing and the pressures it is facing. We are assisting brokers deal with those changes in 10 ways:
  - Growing the market with new listings;
  - Growing the market with new products and asset classes;
  - Improved technology;
  - Index reforms to increase liquidity;
  - More competitive pricing for global order flows;
  - Building liquidity in the small/mid-cap sector;
  - Controlling ASX costs;
  - Cutting the compliance burden for participants;
  - Making progress on broker IDs in the equity market; and
  - Providing benefits to brokers that significantly exceed exchange fees.

- We see the merger with SFE (if it meets the remaining event risks of Treasurer’s approval and SFE shareholder approval) as ASX continuing to meet the needs of the market. Bringing the two exchanges together is a great strategic fit. The combined group:
  - Will have a stronger business in Australia, offering a broad range of equity and derivatives products, and trading, clearing and settlement services, to retail and institutional customers; and
  - Will be better positioned globally to compete for international capital flows and be better positioned for opportunities that may arise from the consolidation sweeping the exchange industry.

- The ACCC will not oppose the merger and further approvals are required from the Treasurer and SFE shareholders. The ACCC considers the proposed acquisition is unlikely to substantially lessen competition. ASX and SFE, to a large extent, do not compete already, nor are they likely to substantially compete in the future.

- We have listened carefully to the issues raised by bodies like SDIA. We will continue to work with stakeholder groups to outline why we do not think there is a basis for concern.

Introduction

Thank you for the invitation to speak today.

When I addressed the SDIA conference last year in Sydney, I said that ASX had a reinvigorated focus on customers. You, our participants along with the listed companies, are important to ASX. We are committed to working together with you to grow Australia's capital markets.

This is not because we are altruistic. It is because our business interests are aligned with yours. If we can help you in your business, your success will help us in our business.

We may not always agree – as we've seen recently regarding some concerns on the ASX/SFE merger – but those differences are a healthy part of a robust relationship.

Whatever the differences, they pale when you look at the health of our markets in Australia - which you and ASX, and the listed companies and the investors, and Government and ASIC have all worked together to achieve.

Just to illustrate:

- Over 10 years – the Australian market has shown an average annual return of 15%, based on the S&P/Citigroup Broad Market Index, the third-best return among developed markets.

- Over last year – the return was even better, 17%.

- Compared to other asset classes, shares and listed products generally continue to perform strongly. We are releasing today a new study conducted on our behalf by the Russell Investment Group which looks at the actual, after tax investment returns of a number of asset classes over the medium and long-terms – 10 and 20 years.

More details on the study are being provided to delegates outside this chamber.

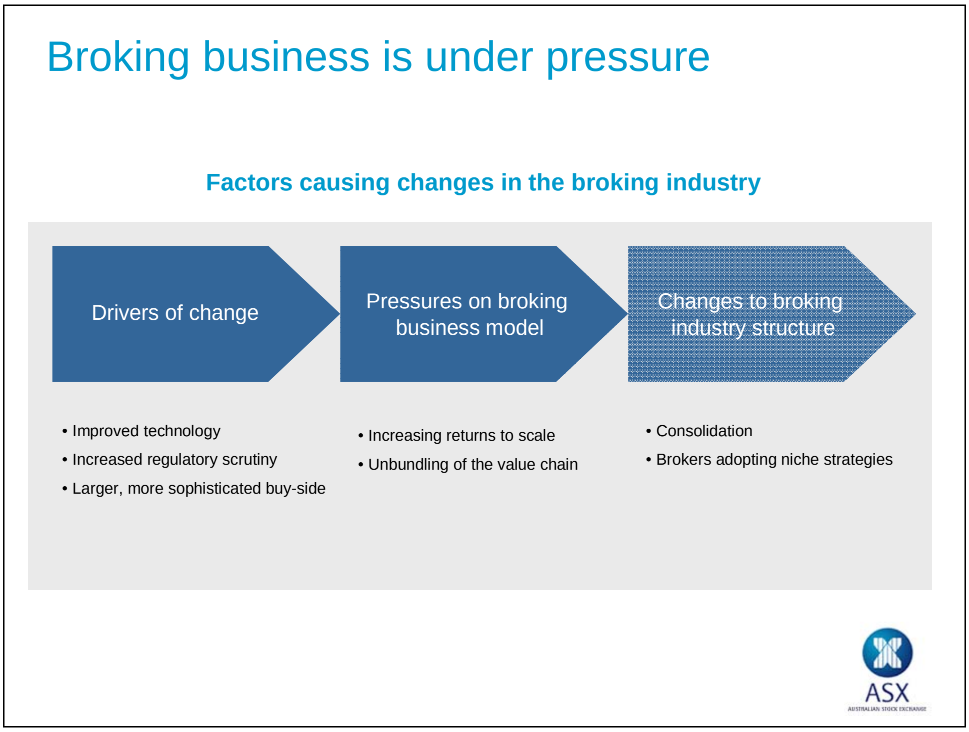
[Let me add, of course, the disclaimer that historical performance is not necessarily a guide to future performance.]

So if we step back a moment, take a helicopter view, we (and all those who contribute to Australia's capital market) should feel very proud of what we have achieved.

So today, I would like to do 2 things:

- First, I would like to develop the theme a little more on how we at ASX are adding value to Australia's capital markets and, more specifically, how we are adding value to your business. I will cover 10 ways in which we are assisting you deal with the changes going on in your industry.

- Second, I'll discuss the ASX/SFE merger and deal with the issues of concern SDIA has raised about the merger. Our view is that the ASX/SFE merger is a definite positive for our market participants … and indeed, a positive for Australia's capital markets generally and, of course, ASX and its shareholders and employees.



Broking business is under pressure

Let me start with the context in which we are saying ASX adds value to the broking industry.

As I have just outlined, we are in good times. However, the broking industry is under pressure.

The industry in Australia is concentrated. 72% of the trade value comes from the 10 largest institutional brokers (most of whom are large global players), and 37% of the value comes from the top-4.

Our market is considerably more concentrated than the US, where the top-4 generate 10% to 14% of value.

The industry has been changing and will continue to change. As you can see from this slide, the drivers of change are:

- **Improved technology**. Faster and more reliable platforms are commoditising execution.
- **Increased regulatory scrutiny**. Increased focus on conflicts of interest, client knowledge and transparency. This adds to cost.

- **Larger, more sophisticated buy-side.** Traditional managers are growing, hedge funds are on the rise and cross-border funds flows are increasing. For example - unbundling of research, commission rates being squeezed.

These drivers are putting pressure on the broking industry model.

- **Increasing returns to scale.** Compliance burdens and technology investments are both scaleable costs, while only large players have the balance sheet and the skill to proprietary trade and develop products.
- **Unbundling of the value chain.** Execution will be increasingly separate from research, while facilitation and proprietary trading can also stand alone.

In turn, we are seeing changes to the broking industry model. It's difficult to predict what these changes will be and there will no doubt be differing views but it could involve:

- **Further consolidation** of execution volume, proprietary trading and new products in a few large players. Economies of scale will push more volume and revenue possibly to 3-5 institutional (and possibly large retail) brokers.

- **Other brokers adopting niche strategies.** Brokers without scale economies may be structurally disadvantaged when competing for execution volume and will have to look elsewhere for revenues.

These possible changes are not unique to the broking industry. They are similar to changes going on in other parts of the financial services sector.

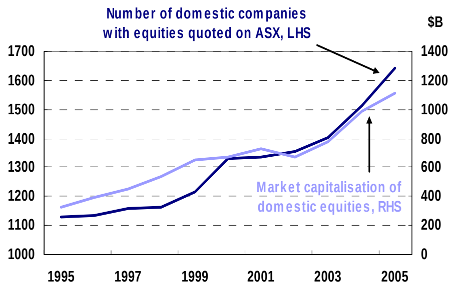
These changes put pressure on brokers. In this environment, it is important to make the point that ASX is not driving these changes. They are not driven by suppliers such as ASX. They are demand driven - by the institutions and other investors - and by the competitive broking environment.

ASX, however, can work to ensure that the equity markets and, if the SFE merger proceeds, the derivatives markets too, are run in a way which facilitates new initiatives to grow revenues, and takes steps to keep the costs of trading, execution and compliance low. In that way, we can provide value to you our direct customers and in doing so, grow our own business – continue to enjoy a healthy relationship with you.

Let me outline 10 ways we do that. Ways in which we help you navigate these troubled waters …

New trading opportunities

1. Growing the market with new listings



Capital raised 2005	
IPOs	$24.18bn
Subsequent	$22.04bn
Total	**$46.22bn**
34% increase on 2004	

1. Growing the market with new listings

First: we work to grow the market with new listings - IPOs and secondary or subsequent raisings. The direct benefit to you is increased trading opportunities.

As the graph on the left-hand side shows - over the last decade, the Australian equity market has grown from $330bn (December 1995) to more than $1.1trn (December 2005).

Last calendar year a record 232 new entities listed. Around 70 have listed so far in 2006 and more than 30 are in the pipeline. As the black line on the left-hand side graph suggests, there are now more than 1600 domestic companies listed on ASX.

In 2005 our listed entities raised more than $46 billion via IPOs and subsequent raisings. According to the latest Ernst and Young international IPO survey, Australia raised the fourth-highest amount of capital globally from IPOs in 2005, behind the US, China and France.

The growth of our markets is due to many factors – including the performance of our companies, your performance and the performance of advisers and others.

ASX's contribution is in 3 areas:

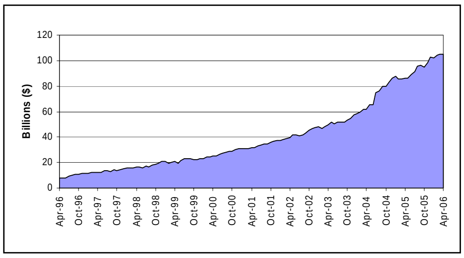
- Assisting to bring companies to the market and/or to raise capital here;
- Generating confidence among investors by the way we (with ASIC) supervise the market; and
- Providing infrastructure (eg trading and clearing systems) for the markets to operate at the level of world's best practice.

If the Australian equity market is the source of your business, ASX, at least, provides the solid foundations for that market.

New trading opportunities

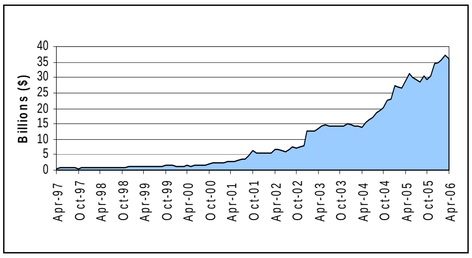
2. Growing the market with new products and asset classes

Listed property trusts market growth
(Capitalisation)



Currently $105 billion
1,241% increase in 10 years

Listed infrastructure growth
(Capitalisation)



Currently $36 billion
6,118% increase in 10 years

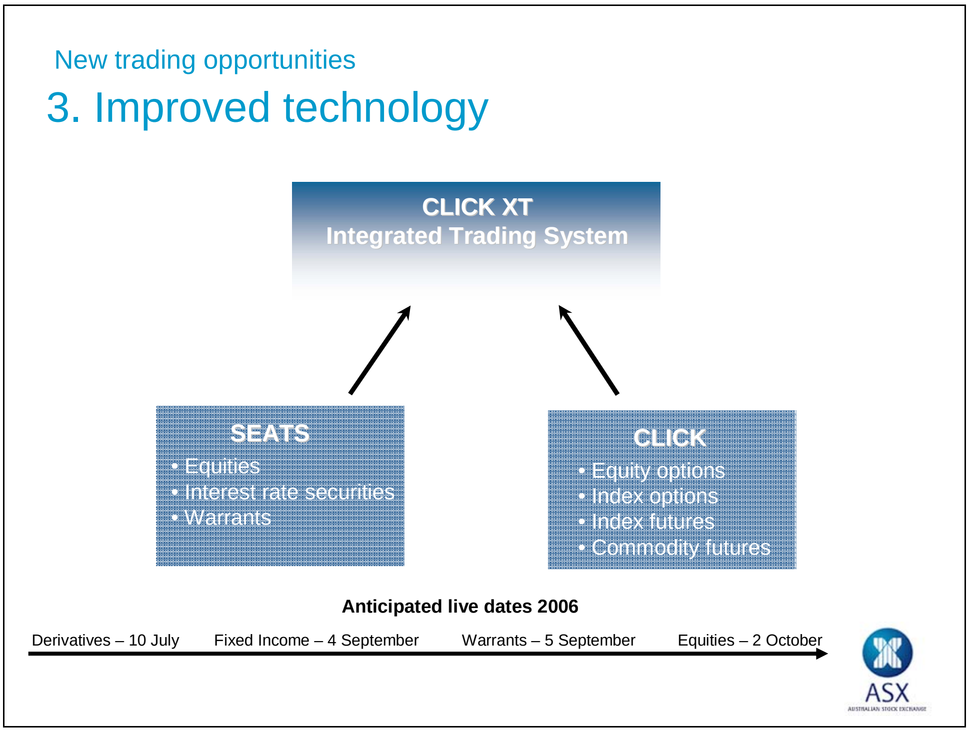
2. Growing the market with new products and asset classes

Second: ASX works with the industry to introduce new products and new asset classes. These provide choice to investors. In turn they contribute to broker revenues.

The slide has 2 prime examples …

The emergence of new and more sophisticated asset classes such as listed property trusts or, as they're known in the US, REITs (real estate investment trusts) - worth more than $105bn – and securitised infrastructure - worth more than $36bn - have added considerably to ASX's depth and to the trading opportunities for market participants.

The market capitalisation of these two sectors has grown significantly over the last 10 years.



3. New trading opportunities with improved technology

Third: we provide new trading opportunities for brokers with new and improved technology. These opportunities add to broker revenues.

ASX was a pioneer of electronic trading when we introduced the SEATS system in 1987. For almost two decades, it has proven strong and reliable.

Later this year we will begin rolling out our new system – Click XT – that builds on the strengths of SEATS and brings together the trading of all our equity and derivatives products onto a single platform.

For brokers it means one screen on your trading desk instead of two. The slide captures that rationalisation.

With this efficiency and functionality comes the ability for contingent trading and a potential increase in broker revenues.

Recognising that the introduction of a new system – even one as potentially beneficial as ITS – does have cost implications for customers, we extended our old pricing structure for a further year to 30 June 2006. This also meant we continued the Settlement Volume Rebate scheme for participants and returned for the nine months to March 2006 $19.9m to brokers.

New trading opportunities

4. Index reforms to increase liquidity

Selected foreign-domiciled companies that may be eligible for inclusion in local indices

- Auckland International Airport
- Anvil Mining
- Equinox Minerals
- Fletcher Building
- Fisher & Paykel Appliances
- Fisher & Paykel Healthcare
- Guinness Peat Group
- Henderson Group
- IAMGOLD Corporation
- News Corporation
- News Corporation (non-voting shares)
- Resmed
- Singapore Telecommunications
- Sky City Entertainment
- Telecom Corporation of New Zealand
- Tower

Key dates 2006

Consultation until 14 June → Announcement by June-end → No change before September index rebalance

ASX

4. Index reforms to increase liquidity in Australia

Fourth: index reforms designed to meet Australian market needs. If implemented, they should assist in keeping companies in local indices, which in turn will stimulate liquidity and trading, and add to broker revenues.

Last week, ASX and Standard and Poor's – ASX's index partner - released a consultation paper detailing proposed changes to the index treatment of foreign-domiciled companies traded on ASX.

The main proposal is that foreign companies listed on ASX may be considered for inclusion in the S&P/ASX indices based upon their Australian capitalisation and liquidity, and under a more transparent and consistent index methodology. Some of those companies that may be eligible are listed on the slide.

The current index rules can result in large Australian companies being removed from the indices if they choose to re-domicile to another market. The specific example here is News Corporation. The proposed changes will mean that such companies can remain in the local index in proportion to their Australian capitalisation and liquidity.

More importantly, the proposals will increase the attractiveness of an ASX listing to foreign companies that acquire significant ASX-listed companies, creating further investment opportunities for Australian investors.

Australia's indices will more accurately reflect the needs and characteristics of the Australian market.

We are seeking feedback on these index proposals until 14 June with a view to implementation by September. We would welcome your comments. We should stress that the proposed methodology is subject to consultation and as such, subject also to change. Please check our website for details.

New trading opportunities

5. More competitive pricing for global order flows

Service	ASX			
Order fee	No charge	No charge	No charge	Monthly access fee based upon number of orders
Trade execution	0.28 basis points capped at $75	0.75 basis points uncapped (but includes trading terminal fees)	0.5 basis points uncapped	Sliding scale typically from 2.9 to 1.5 basis points
Transaction clearing	0.25 basis points uncapped	5.0 basis points (capped at SG$200)	0.2 basis points capped at HK$100	0.06 basis points uncapped
Transaction settlement	$1.60 delivery with payment $0.90 delivery without payment	Included in clearing fee	Included in clearing fee. HK$1.20 per cash transfer	Two-tiered, volume-based system

Based on post-1 July ASX pricing structure

ASX

5. More competitive pricing structure

Fifth: a more competitive pricing structure to reduce complexity (and hence your costs) and to attract new forms of DMA or program trading.

The new pricing structure we unveiled in December last year and updated late last month will come into force on 1 July 2006.

Aligning our pricing more closely with other exchanges (as this slide shows) in our region improves our competitiveness and allows us to attract greater global order flows. Greater flows coming in mean greater trading opportunities locally for you.

We expect to attract more price-sensitive flows from Direct Market Access (DMA) funds and algorithmic traders. Approximately 20% of ASX's activity currently comes from DMA and algorithmic trading.

Our new pricing arrangements are also simpler – we've cut the number of pricing points from 109 to less than 50.

The changes also establish a tighter alignment between ASX pricing and broker revenue drivers.

We will also introduce a Volume Incentive Program (VIP) to recognise and incentivise the significant contribution to market liquidity provided by the largest ASX participants. The VIP rebate is payable to individual participants once certain turnover thresholds are reached.

To further reward providers of liquidity, a Supplementary VIP rebate pool (capped at $8.5m) will be set-up that will increase as market turnover grows, and from which individual participants may be eligible for a payment based on their total individual billable turnover.

Details of these are on our website.

I will say more on pricing a little later in relation to the ASX-SFE merger.

New trading opportunities

6. Building liquidity in small/mid-cap sector

- Increasing the amount of capital that can be raised in any year to greater than 15% of existing value
- Reducing the number of shareholders required at an IPO to less than 400
- Lowering the minimum listing price for stocks to less than 20 cents
- Generating analyst coverage and a better understanding of investor relations
- Two new real-time indices - the S&P/ASX Metals & Mining Index, and the S&P/ASX Gold Index
- Promoting to Government the benefits of a flow-through share scheme for the mining industry

ASX

6. Building liquidity in the small/mid-cap sector

Sixth: we are working to build liquidity in the small to mid-cap sector to increase trading which will feed into broker revenues.

SMEs, defined as companies with a market value up to $100 million, represent two-thirds of all ASX-listed companies – that's more than 1,200 entities. They are the important to our market.

That's why we have a differentiated markets strategy to help drive liquidity in this area.

Stimulating liquidity will not only benefit ASX commercially but also generate trading opportunities for brokers.

We have surveyed the SME sector and those who invest in the area about the need for greater flexibility in our listing rules and for ways to stimulate liquidity. Consequently, we are finetuning a number of initiatives to help grow the sector - but without jeopardising market integrity. These include:

- Increasing the amount of capital that can be raised by SMEs in any year to greater than the current 15% of their existing value;

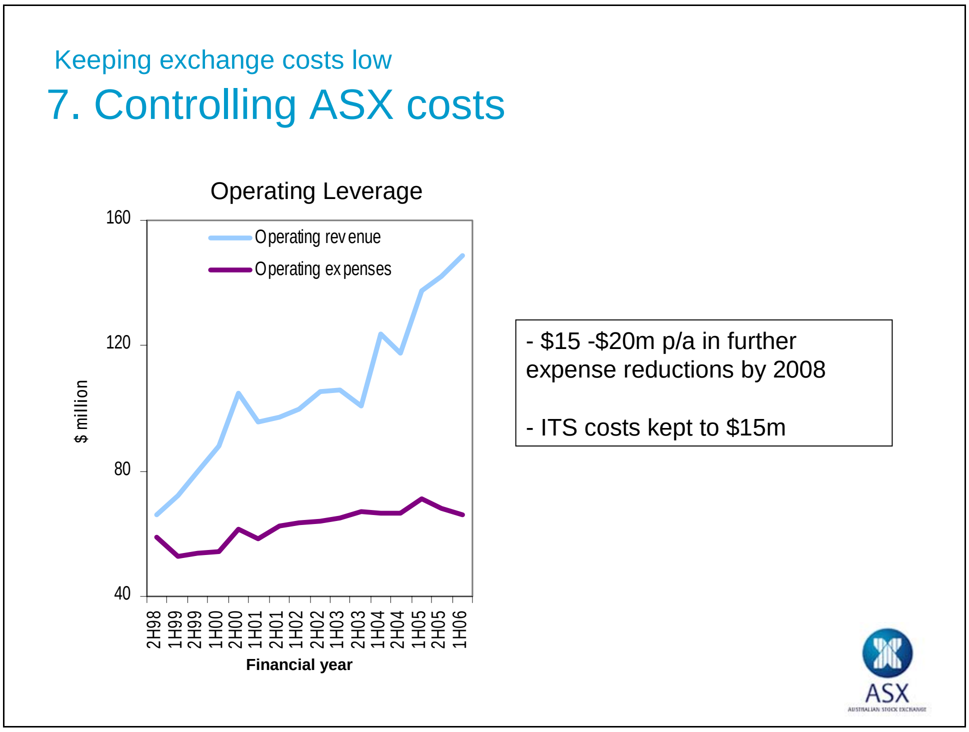
- Reducing the number of shareholders required at an IPO to less than 400 and lowering the minimum listing price for stocks to less than 20 cents;

- Generating analyst coverage and a better understanding of investor relations;

- Introducing two new real-time indices - the S&P/ASX Metals & Mining Index, and the S&P/ASX Gold Index; and

- Continuing to promote to Government the benefits of a flow-through share scheme for the mining industry.

We will work through the implications of these initiatives with the industry and, importantly, with ASIC the regulator. We will not, of course, overlook the rights of existing shareholders or the need to preserve and improve market integrity.



7. Controlling ASX costs

Seventh: controlling our own costs. In doing so, we keep downward pressure on fees.

You will see from this graph how we are working to flatten our expense structure. We've been able to do this by re-structuring the business and by reviewing our profit and loss drivers. Our aim is to reduce expenses by $15m to $20m from the current levels by FY08 (subject to inflation and new projects).

We know that we need to continually improve to keep costs low … just like you, our customers, are doing. It's a constant pressure we both feel. As with all businesses, the benefits arising from our discipline on costs will continue to pass through to our charges and pricing.

Reducing broker costs

8. Cutting the compliance burden

- RPU set-up in part to cut red tape for participants
- ASX Operating Rules being streamlined
  - Reduce complexity
  - Remove overlap with Corporations Act
  - Introduce more principles-based rules
  - Develop more Guidance Notes
- Ensure rules provide certainty and remain relevant

ASX
AUSTRALIAN STOCK EXCHANGE

8. Cutting the compliance burden

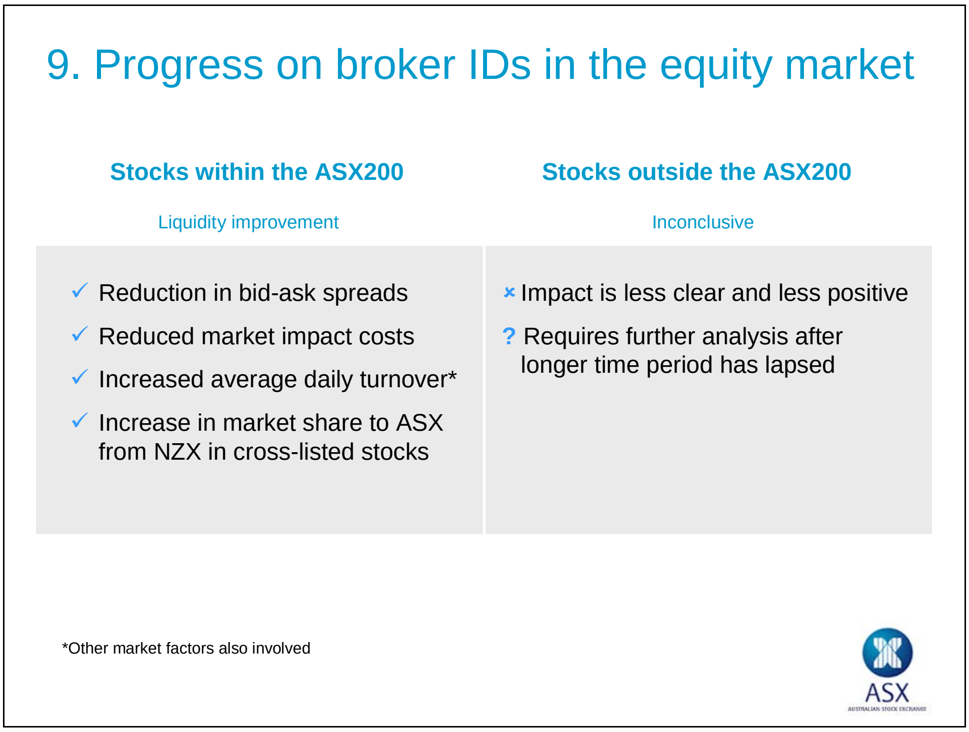
Eighth: reducing the compliance burden. In doing so, we assist brokers keep their compliance costs down.

ASX is conscious of the compliance burden on brokers (as, I might add, is the Government and ASIC). One of the reasons for setting up the ASX Regulatory Policy Unit late last year was to help develop strategies to cut the red tape costs for market participants.

The RPU is managing a rewrite and streamlining of ASX's Operating Rules. We will introduce more principles-based rules - without diminishing market integrity - that reduce complexity, unnecessary overlap with the Corporations Act and the costs of compliance.

We will also introduce sunset clauses and remove non-operating rules. We will develop new Guidance Notes to clarify the use of ASX's supervisory discretion and identify gaps in the existing rule framework.

These initiatives will ensure that our rules provide certainty for participants, remain relevant and up-to-date, and help keep compliance costs low.



9. Progress report on broker IDs in the equity market

Ninth: we removed broker IDs which we saw as being an overall benefit to the market, generating improved liquidity.

On 28 November 2005, after extensive consultation with industry and careful consideration of international studies and trends, ASX removed broker identifiers in real-time. Now, market share information is released at the end of every trading day and the full trading history – with broker identifiers – is made public three days after the trade.

Since the implementation date, total trading activity on ASX has continued to grow strongly and a number of new market turnover records have been set.

However, at last year's SDIA conference I said we would continue to listen to our customers and study the impact of the broker anonymity decision.

We have commissioned an independent study. That study has 2 aspects:

- One - "academic" or quantitative research carried out by SIRCA (the financial services research organisation established by 25 collaborating universities); and

- Two – industry input to examine the practices and practicalities of trading in the new environment.

The full study will be completed at the end of November this year, consistent with our commitment to review the change over a 12-month period.

For this conference, and by way of update, we asked SIRCA for a progress report.

SIRCA evaluated 471 stocks from the All Ordinaries index.   It compared a 60-day post-period (28 Nov. 05 – 23 Feb. 06) to two 60-day periods before broker IDs were removed (5 Sep. 05 – 25 Nov. 05 and 29 Nov. 04 – 28 Feb. 05).

SIRCA also examined the effect of stocks listed on both ASX and NZX since the removal of broker IDs. NZX has broker IDs.

The key results are on the slide …

In summary, to date, the impact of this change varies depending on the stocks examined.

The removal had a positive impact on the liquidity of stocks in the S&P/ASX200 index which covers about 78% of the value of the Australian equity market.
These stocks (as you will see from the slide):

- Tightened bid-ask spreads by 2.2 to 3.5 basis points;
- Reduced market impact costs by .5 basis points for a $100,000 order; and
- Increased average daily turnover by $4.2m per stock compared to the previous corresponding period (although other factors could also explain this increase).

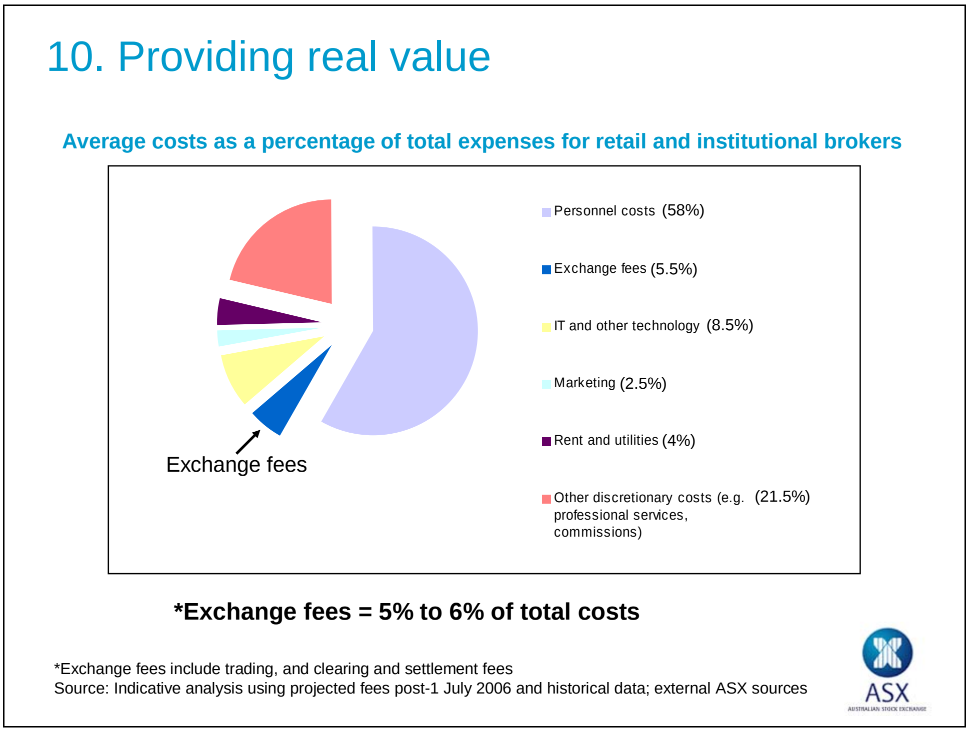
Among stocks cross-listed or dual-listed on ASX and NZX:

- There was an increase in ASX's share of trading volume of 1.6%.

The impact on stocks outside the S&P/ASX200 is less clear and less positive. The results here differ depending on the comparison periods. At this stage, SIRCA is saying "inconclusive".

SIRCA recommends that further analysis of the non-S&P/ASX200 stocks should be undertaken after a longer time period has elapsed after the removal of broker IDs. We have asked SIRCA to continue with their work.

So far, the results do not show that we need to reverse the decision – ie, there has not been a detrimental effect on the market. However, for stocks outside the 200, we are on notice that a closer examination needs to be done.



10. ASX provides real value

Tenth: when our fees are put in the context of total broker expenses, they provide a value that significantly outweighs their cost.

ASX provides market infrastructure for the trading, clearing and settlement of around 115,000 trades a day. That infrastructure underpins broker revenues.

This slide provides estimates of what we think broker expenses look like. This came out of work we commissioned and not from internal ASX sources.

According to these estimates, the average exchange fee – for retail and institutional brokers combined – is around 5% to 6% of total broker costs.

Other costs, as you can see on the slide, such as for personnel, IT and other discretionary spending, represent a significantly larger slice of your expense pie.

These are only our estimates and may vary depending on the broker.

Nevertheless, we can make 2 points:

- Our fees provide real value for money; and

- The improvements we are making to our systems and the offering of further scale with SFE (if we are successful) should enable brokers to reduce their costs further over time (especially in areas such as the back-office).

ASX's fees also need to be assessed against market impact costs. In our market, market impact costs are low – another key benefit.

In short, the value ASX provides to the broker industry outweighs the costs it charges in fees – costs which are more than competitive with other exchanges … and costs which we are working hard to keep low.

10 ways ASX is adding value to broking industry

	Broker benefits: Revenue	Broker benefits: Costs
1. Growing the market with new listings	✓	
2. Growing the market with new products and asset classes	✓	
3. Improved technology	✓	
4. Index reforms to increase liquidity	✓	
5. More competitive pricing	✓	
6. Building liquidity in small/mid-cap sector	✓	
7. Controlling ASX costs		
8. Cutting the compliance burden		
9. Progress on broker IDs in the equity market	✓ ?	
10. Providing real value (fees as % of total expenses)		

So in summary, in the first part of what I have covered:

- We understand the challenges the industry is facing even if we are in good times.

- We believe we are working to provide value to enable you to meet those challenges.

Let me now move to the second major topic of today's speech and cover the ASX/SFE proposed merger.

Benefits for ASX's broker participant customers

- Back-office efficiency via consolidated systems
- Potential clearing house efficiencies
- Improved platform for product innovation and revenue growth
- Environment for increased trading in SPI contract
- One front-line market supervisor

The ASX/SFE Merger

ASX is very enthusiastic about the prospect of a merger and the SFE Board has unanimously recommended the proposal to its shareholders in the absence of a superior proposal. If the deal is completed, it will be an important milestone for Australia's capital markets.

It is still, of course, subject to the Treasurer's and SFE shareholders' approvals.

A combined ASX-SFE will create the leading financial markets exchange in the Asia-Pacific region and be the ninth-largest listed exchange group globally, valued at more than $5 billion (approx).

Bringing the two exchanges together is a great strategic fit.

- First, the combined group will have a stronger business in Australia, offering a broad range of equity and derivatives products, and trading, clearing and settlement services, to retail and institutional customers.

- Second, the combined group will be better positioned globally to compete for international capital flows and be better positioned for opportunities that may arise from the consolidation sweeping the exchange industry.

In other words, the merger will create the right exchange 'footprint': that is, an exchange that serves customers best by offering an integrated range of products and services. This will be good for our domestic business and crucial as cross-border competition for investment order-flows increases.

Let me expand on each of these two benefits.

Domestically the merger proposal is not just about size and scale; it's also about delivering benefits to our various stakeholders. Let me concentrate on benefits for you, our broker participants.

For example, market participants or brokers - ASX/SFE customers - should benefit from:

- o Cost synergies such as potential back office cost savings via the integration of trading and clearing systems;
- o Potential clearing house efficiencies related to the amount of capital lodged and margin offsets;
- o A better environment for product innovation and revenue growth from new products;
- o Increased volumes for existing products, especially the SPI (SFE's share price index contract) with its alignment to ASX equities; and
- o Lower compliance costs with a single front-line market supervisor.

Of course, ASX/SFE shareholders, investors and employees also stand to gain. The full extent of the benefits from combining the two exchanges will become clearer in the weeks and months ahead.

The stronger domestic business will also better position us globally. Recent weeks and days have seen intense maneuvering among the big five exchanges in Europe and North America as NASDAQ takes a position in LSE, and New York and Deutsche Borse compete for Euronext.

In our own region, the chairman of the Tokyo Stock Exchange recently said consolidation of international securities markets is inevitable and "we wish to be at the head of one of these groups".

And, even closer to home, both Singapore and Hong Kong consolidated their stock and futures exchanges some years ago.

Exchanges are positioning themselves for increased cross-border activity. The desired footprint - or business model - for successful exchanges today is the offering of equity and derivatives products with clearing and settlement services as well.

A successful merger will give ASX that footprint. We will be better positioned to participate in global and regional moves, should they occur.

It is, however, important to emphasise that there are still 2 important "event" risks:

- Treasurer's approval; and
- SFE shareholder approval.

We are not presuming or pre-empting the outcome of these.

ASX/SFE merger is *not* anti-competitive

Why?

- Because ASX and SFE do not compete with each other … there cannot be lessening of competition

- ACCC has stated that the current lack of competition between the two exchanges is unlikely to change in the foreseeable future

We were pleased to receive ACCC's informal clearance on Wednesday. Let me expand a little on the competition issues.

Our contention - as the slide shows - is that the merger with SFE will not result in any substantial lessening of competition in any relevant market. Neither ASX nor SFE currently act as a competitive constraint upon the other nor will they in the future. This is because of what's termed "network effects". Basically, once liquidity pools have formed (eg equities or derivatives), the ability to shift that liquidity pool is extremely difficult. Attempts by ASX to move into debt derivatives or SFE into equities are not likely to succeed.

This is summarised as follows by the ACCC when it said:

"The ACCC considers the proposed acquisition is unlikely to substantially lessen competition given the strong evidence that the ASX and SFE are separate monopolies, and to a large extent do not compete already, nor are they likely to substantially compete in the future".

It also added:

"The ACCC received no persuasive evidence that the current lack of competition between the ASX and SFE was likely to change in the foreseeable future … Further, both local and overseas experience suggests that it is very difficult for exchanges to attract trade in financial products away from other exchanges".

It does not follow, however, that ASX's behaviour as a market operator is not constrained. It is. It is constrained in a number of ways. Let me expand:

First, there are regulatory constraints. ASX continues to be subject to regulatory oversight by ASIC. ASX is a licensed market operator. ASIC has indicated (*AFR*, 12 April 2006, p54) that it does not see a need to impose conditions on our licence as part of the merger.

ASX is also subject to ACCC regulation (eg under provisions of the Trade Practices Act).

And ASX as a regulator itself has a legal obligation and commercial incentive to ensure that it discharges its supervisory responsibilities effectively and conducts itself in an efficient and pro-competitive manner. Simply stated, ASX has to set the example in the way it conducts its business.

Second, there are industry constraints. ASX continues to be subject to the constraints imposed by the globally competitive environment in which our customers – brokers and listed companies and our exchange peers - increasingly operate.

Among our customers, many brokers have significant bargaining power by virtue of their role within large international investment banks. There are alternatives to organised exchanges for parties seeking to transfer risk and capital, including: internalisation of trades by significant brokers that by-pass exchange platforms; OTC (over the counter) transactions; and Alternative Trading Systems (ATS).

Thirdly, ASX is one of the most publicly scrutinised companies in Australia as can be seen, for example, by the extensive media coverage it receives. This close scrutiny works to ensure ASX acts fairly in its dealings with all its stakeholders. Again, we have to set the example in the way we conduct our business.

These constraints existed prior to the proposed merger and will continue post-merger. The merger does not reduce these constraints.

SDIA's issues

Clearing and settlement

- ASX provides access to CHESS in a fair and effective manner
- CHESS regime recently reviewed with rule changes proposed

Product innovation

- Merger will not limit product innovation. This is primarily driven by market participants

Return on equity

- The 'equity' component of ROE for exchanges is artificial

ASX

AUSTRALIAN STOCK EXCHANGE

SDIA's issues

In the course of the ACCC's market enquiries, SDIA and AFMA in press releases, while not opposing the merger, expressed concern about certain aspects of the merger.

I would like to briefly touch on these. In doing so, I'll focus on the competition aspects. I am not losing sight of the fact that even if the concerns are not competition-related or not strictly matters for this merger, they are important matters to these associations and we will continue our dialogue with them. Indeed we will also cover these and other issues with those associations who have supported the merger and not raised these concerns.

Clearing and settlement

SDIA raised concerns about access to clearing and settlement facilities:

Let me outline the position on access:

- ASX already provides access to CHESS and has done so for some time.
- Rule changes have been proposed which further strengthen transparency and objectivity when applying for access.
- SFE's access to derivatives clearing and settlement is similarly open.
- ASX and SFE do not provide clearing and settlement facilities in competition with each other. For example, SFE does not have an equities clearing capability.

It needs to be borne in mind that from 1969 to 1991 SFE's clearing arrangements were provided by ICCH - a London-based provider of clearing services to various exchanges internationally. ICCH is now known as LCH.Clearnet, a leading clearing service provider in Europe. It has extensive operations in international markets.

So, not only is there existing access to clearing and settlement facilities but there are alternatives too. As well, our market participants have the resources to establish alternative clearing and settlement facilities if they wish.

Product innovation

Concerns have been expressed that product innovation will be less with a merged exchange.

Patterns of trade in Australian exchange-traded products show that there is very little overlap in the products traded on ASX and SFE. The vast majority of trade on each exchange is in financial products not traded on the other exchange. There is no evidence to support a claim that substantial competition between ASX and SFE exists, let alone a claim that such competition has resulted in the emergence of new products and improved services.

The ACCC said: “Market inquiries also raised some concerns that the merger will reduce product innovation. However, the ACCC concluded that product innovation is driven primarily by market participants devising products to meet client needs.

“These products are not necessarily traded on exchanges, nor is there any significant evidence of innovation being driven from competition between the ASX and SFE.”

We would add that the strength of ASX post-merger - operationally and financially - will enable it to work with participants to introduce more new products than either exchange could have done on its own.

We welcome the opportunity to discuss new products. We will be delighted to bring new products to market.

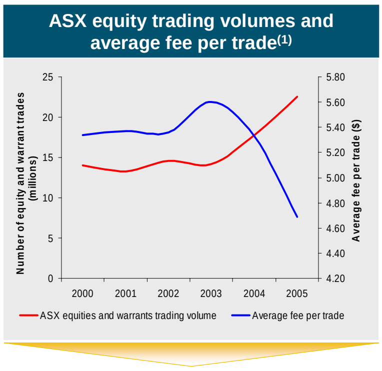
Return on equity

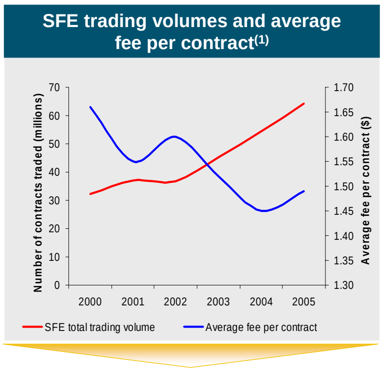
SDIA has noted that both ASX and SFE had a high return on equity (ROE).

The focus on return on equity has no real validity for exchanges because the “equity” in these structures is artificial - ie a residual of many years of mutuality.

I can explain this artificiality this way. Post-SFE acquisition, the ROE for ASX/SFE will drop to around 9%. We do not propose to use that relatively low return to justify lifting prices as the “equity” component will then be lower than what other comparable companies seek. It simply illustrates the artificiality of this. The better test is to look at our fees as a percentage of brokers’ total costs (which I covered earlier).

Prices have been declining relative to volumes





- Graph shows year end June 05
- Average fees have fallen 12% from 2000 to 2005

- Graph shows year end December 05
- Average fees have fallen 10% from 2000 to 2005

Source: Annual reports

Pricing

Discussion has also centred on ASX pricing as an example of how it could use its powers. But the issues around ASX pricing are, as the ACCC said, unrelated to the merger. ASX and SFE simply have not constrained each other's pricing.

The concerns on pricing have arisen around the changes to our pricing structure. Also, there has been an "opportunistic" element of using the merger to exert pressure on ASX. Let me set out some facts.

First, exchange prices relative to volumes have been decreasing steadily for a number of years. As the slide shows:

- Average ASX fees per trade have fallen 12% from 2000 to 2005.
- Over the same period, average SFE fees per contract have fallen 10%.

And the changes we are proposing to our pricing (from 1 July) will not reverse this overall decline in exchange prices relative to volumes.

Second, the new ASX pricing structure was introduced in response to industry concerns to attract, for example, more DMA order flow. The move to a more value-based rather than volume-based model is not without risk to ASX.

Third, in terms of impact of ASX's new pricing, a significant number of broker participants will receive price reductions. Where there are increases, at the institutional end, they will correct what the market recognises as a disproportionate share of the existing discount – the Settlement Volume Rebate. Even so, we have committed to modify the impact with the two-tier Volume Incentive Payments (VIPs) for the large liquidity providers.

In formulating the new prices, ASX has had regard to customer impact. Given the complexity of the change (a change that the industry wanted), we believe the final structure is fair to the participants and to ASX.

Conclusion

- ASX and broker interests are aligned
- ASX is adding value (in 10 ways) to the broking industry
- The ASX-SFE merger (if it proceeds) is a definite positive for the industry
- ASX will continue to listen to and work closely with our stakeholders on merger issues

Conclusion

So let me conclude …

In the first part of this presentation I covered how ASX is working to deliver value. I outlined 10 ways we were assisting brokers to meet the pressures the industry is facing. Our interests are aligned – you are important customers for us and for our future. We are doing our best to look after you.

We see the SFE merger (if it meets the remaining event risks) as ASX continuing to meet the needs of the market. It is an important milestone for Australia's capital markets.
We have listened carefully to the issues which have been raised. There have not been, as I outlined, competition issues. However, there are issues of concern to you and we will work with you and SDIA, and AFMA and other bodies like IFSA, to outline why we do not think there is a basis for concern.

In this context, I am particularly grateful for the opportunity to speak with you today and to present ASX's views. Thank you again for the invitation.