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Mr David Murray AO
Financial System Inquiry
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Murray,

Congratulations on your appointment as Chair of the Australian Government's Financial System Inquiry. ASX welcomes the announcement of the Inquiry, and appreciates the opportunity to comment on the draft Terms of Reference.

In contributing to the Inquiry, the focus of ASX will be on the future of Australia's financial markets. It is our aim to have viable and globally competitive financial markets based in Australia.

We believe that our input may also have relevance for other parts of the financial services industry, particularly those that are impacted by changes in the global regulatory environment.

ASX is well placed to contribute to the Inquiry

Australia's financial markets are efficient and punch above their weight. On most metrics our financial markets are globally competitive and significant:

- **Investable assets:** At \$1.7 trillion, Australia has the 3rd largest pool of investable assets in the world.
- **Capital formation:** Since the start of the GFC, Australian companies have raised almost \$390 billion, ranking Australia 4th in the world in capital raised.
- **Equity markets:** Australia has more than 2,100 listed entities, with a total market capitalisation of \$1.5 trillion. Australia's free float of \$1.2 trillion ranks 8th in the world.
- **Derivative markets:** Australia's interest rate derivatives market is the largest in Asia and ranks in the top 5 globally. In 2013 the exchange traded derivatives market had notional turnover of \$47 trillion.

Today, ASX is the 7th largest listed exchange group measured by market capitalisation. As a company, ASX is broadly the same size as the London Stock Exchange, NASDAQ and the Singapore Stock Exchange. ASX ranks ahead of the Toronto Stock Exchange.

The stable regulation and structure of Australia's financial markets underpin their performance and competitiveness. ASX is a multi-asset class and vertically integrated exchange. This means that the exchange operates both equities and derivatives markets and provides a full suite of services from listings to trading, clearing, settlement and depository services.



The ASX business model is typical of exchanges in the Asian time zone. Singapore, Hong Kong and Japan have similar models. The business models in Asia are different from those that operate in the USA and Europe, where markets are larger and fragmented, and where exchanges typically have narrower business models around equities or derivatives.

These differences in scale, market structure and business models matter. They determine to a considerable degree whether financial markets and exchanges are successful and globally competitive.

The Terms of Reference for the Inquiry are appropriate

ASX is supportive of the Terms of Reference. They recognise that a broader perspective is needed in a world where the advancement of technology and global regulatory changes will have a material impact on the business models and competitiveness of the Australian financial sector.

In relation to financial markets, ASX supports the Inquiry's focus on:

- The end users of our financial system – individuals, companies and investors. Our experience is that too often decisions around financial markets are made without explicit reference to end users. Australia is doing better than many other markets in this respect, with both ASIC and the RBA paying increasing attention to the needs and interests of end investors.
- Supporting Australia's economic growth and the efficient allocation of capital. Any outcomes should strengthen the long term health of our financial markets and their ability to support the three reasons they exist: capital formation, long-term investment and risk transfer.
- Balancing competition, innovation and efficiency with stability. Australia's financial markets are world class. The GFC and the collapse of Lehman Brothers and MF Global have demonstrated the importance of giving investors access to a well-regulated domestic market.

It will be important that Australia's regulators retain a level of control over the markets that are critical to our economy, and that investors continue to have access to financial markets that allow them to manage their risk and collateral under Australian law. Following the GFC, this is a choice that investors value and increasingly require. They need to have the confidence that there is a viable domestic service available to them.

To achieve the right outcome it may require explicit measures and mandates to ensure that Australia does not find one day that it has 'outsourced' its financial markets to overseas financial centres – balanced against the reputation of Australia as an open and competitive economy.

ASX understands its role in Australia's financial markets and is making significant investments to ensure that investors continue to have access to a world class financial market infrastructure. In July 2013 ASX raised an additional \$553 million of equity, with most of the funds being allocated to its clearing houses. As a result, ASX's clearing operations are expected to meet the highest global capital standards which will enable ASX to service global operators.

- Global competitiveness and the impact of international financial regulation. Australia's economy and financial markets are strong but relatively small. Today, the domestic regulatory settings seem largely appropriate and Australia's regulators are highly respected by their peers.

When we look forward, the issues we face collectively are less about the settings *in* Australia and more about the competitiveness *of* Australia.



International financial regulations determine how global players can transact and, consequently, are having an increasing impact on the way Australia's financial markets operate. Several of the new regulations favour markets with significant scale and the largest players in Australia are international investment banks.

Moreover, in the USA and Europe we are currently seeing a further round of exchange consolidation. For example, the Intercontinental Exchange (ICE) has just completed the acquisition of the NYSE Group and will proceed to break up this business.

Over the next few years several large international exchange groups will emerge. Their market capitalisations are likely to be several times that of ASX. Australia needs to ensure that its provider of critical Financial Market Infrastructure has the size and balance sheet strength to compete and invest.

Therefore, the Inquiry should consider the conditions and trade-offs (for example, in market structure or regulations) that can help secure and strengthen Australia's global competitiveness and domestic strength in a changing regulatory landscape.

The above considerations mean that the Inquiry should take a holistic view of Australia's financial markets and keep a clear eye on global changes. It should give clear guidance to regulators and the Government on the approach they should adopt to consider regulatory changes in future. The significant demands that are now being placed on financial markets and exchanges mean that Australia can no longer afford to take a piecemeal (that is, business-by-business) approach if it is to remain globally competitive and relevant.

ASX would recommend that the Inquiry focuses on areas where global changes have the greatest impact. In financial markets this includes derivatives (exchange traded and over-the-counter) and the management of Australia's financial market infrastructure. Both are subject to global forces and are material to the future of the sector and the economy.

In most domestic markets, Australia's regulators and the government have made significant progress. For example, last year the Council of Financial Regulators conducted an extensive review of the domestic market structure for cash equities clearing and settlement. The Council recommended that the existing market structure be retained for a period of at least two years. The Government accepted the Council's recommendations. ASX has implemented a Code of Practice and engaged with industry to ensure that it delivers efficient outcomes to the Australian market place. Towards the end of 2014 the Council will conduct a further review and once more make a recommendation to the Government on the ongoing market structure. The process for this is well understood by all market participants and ASX recommends that it is completed as planned.

The Inquiry should draw external input broadly

Given the Terms of Reference, ASX recommends that the Inquiry draws on a range of experts and experiences.

In the earlier sections of this letter, we conclude that there are material differences between the markets in the USA and Europe and those in Asia – measured in scale, market structure, participant profiles and business models. These characteristics determine to a considerable degree whether financial markets are successful and globally competitive.

Therefore, it is important that the inquiry considers both the similarities and the differences between markets. It may be tempting to 'copy' the market structures and business models that operate in the USA and Europe. Our experience with doing this in Australia so far has been mixed.



Instead, it is often the differences that provide the competitive strengths for smaller markets that lack the scale of the US and European markets. Governments in Asia recognise this and so should Australia.

For the Inquiry to draw on the best possible expertise in financial markets, an expert panel should include:

- Representatives from end investors. Investors, including superannuation funds and fund managers, should have a strong voice as the ultimate end users of our financial markets.
- International experience, including from the Asian region. Any expert panel should be able to understand and articulate the implications of its recommendations for Australia's regional and global competitiveness. Broad experience across a range of geographies will be important to ensure that the advice is relevant.

Thank you once more for consulting on the Terms of Reference. There is no doubt in our mind that the Inquiry provides an opportunity to further strengthen Australia's position in financial markets – in Asia and globally. We should not miss it.

We look forward to working with you and the Committee over the coming months.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Elmer Funke Kupper', is written over several horizontal lines.

Elmer Funke Kupper