

# Open Market

Australian Stock Exchange  
Exchange Operator Report  
An information resource



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What makes a stock exchange tick?  
How does a "market operator" operate a market?  
Who owns the exchange, and how is it licensed?

In a nation where more than half the adult population owns shares – and where every Australian worker has a stake in the market through his or her superannuation savings – these issues are important. And not just for investors, but companies too, seeking funds to grow in a competitive environment. The Australian Stock Exchange serves both investors and companies by operating a market of efficiency and integrity, in which everyone can participate with confidence.

Confidence is central to a successful market – and in this report, we describe how ASX seeks to build and maintain confidence in the market we operate.

This is a companion to the ASX Report to Shareholders 2003/04, issued in August 2004, supplementing its financial and statutory reporting with a review, for a broad industry audience, of the daily challenges involved in operating a leading financial marketplace.

## Where have we come from and what do we do?

The Australian Stock Exchange (ASX) is not a stockbroker, nor a fund manager, nor a bank, nor an arm of government. It is a licensed operator of a market for shares and other financial products.

ASX is a national organisation whose markets service the entire Australian economy. But this was not always the case. ASX was formed in 1987 through the amalgamation of the six separate stock exchanges that had operated independently in each state of Australia. Each of those exchanges had a continuous history dating back to the colonial era – the Sydney exchange was formed in 1871, Hobart in 1872, Brisbane and Melbourne in 1884, Adelaide in 1887 and Perth 1889. (The forerunner to them all had been born on the Victorian gold fields in the 1850s.) This heritage continues to be reflected in ASX's operations, with offices serving the business and investment community in the capital cities of each state.

ASX market – vital facts  
As at 30 June 2004

Market capitalisation	A\$841 billion
Market capitalisation as a % of GDP	95%
Number of listed companies	1,638
MSCI global index weight/ranking	2.04%/9th
Number of "brokers"	85
Market turnover (12 months to June)	A\$628 billion
Daily average equities trading (volume/value)	68,471/A\$2.4 billion

Like exchanges elsewhere, ASX was initially structured as a not-for-profit mutual company owned and managed by its "members" – the stockbrokers who had created it in the first place as the forum for their transactions with each other. "Members" who owned "seats" in the exchange were permitted to buy and sell shares as member stockbrokers. As owners they also had a say in how the exchange would operate to meet their needs as stockbrokers. Through the 1990s, however, it became apparent that this structure might not best meet ASX's and the market's future strategic needs, and in 1996 the ASX Board asked the members to consider the key challenges facing the exchange:

- What competitive challenges were ASX facing and would a different structure help meet those challenges?
- Were the interests of members diverging and the benefits of membership being spread evenly?
- Were members' interests diverging from those of the exchange they owned?
- Was it unsustainable for exchange ownership to lie with one group of exchange customers?

The response led to the decision to demutualise – members swapped their membership rights for shares, effectively separating ownership of the exchange from access to its services. Henceforth, it would no longer be necessary to be a stockbroker to own shares in ASX. This transition required legislative approval from the Australian Parliament in the form of amendments to the Corporations Act.

Demutualisation took place on 13 October 1998 and the following day ASX became the first exchange anywhere in the world to demutualise and list on its own exchange. (The model has since been followed by other exchanges around the world, including the major bourses in London, Singapore, Hong Kong, Toronto and Frankfurt.)

Now ASX shares are bought and sold on ASX's market like those of any other listed company. The amount of ASX's issued capital owned by the former "members" has steadily declined and is now just 23% of the total. Their place has been taken by institutional and individual investors.

Overseas institutions own 10% of the company; Australian investors own the balance – represented not only through institutional investors (with 32%) but also directly. In fact, the largest single group of ASX shareholders are private Australian individuals, who own 35% of ASX's issued capital.

Demutualisation has allowed ASX to expand the range of financial products for which it operates markets and the services it offers. ASX is much more than a "stock exchange": while the buying and selling of shares (equities) remains central, ASX's operations cover a diverse set of financial products and functions.

ASX also provides markets in options – and has done so since 1976, being the first market outside the United States to do so – and warrants, which were first traded on ASX in 1990. ASX's fledgling futures market began in January 2002 and now includes products in equity indices, a listed property trust index, commodity and other agricultural futures products. ASX's interest rate market, in its present form, was established in late 1999.

The historic decision to demutualise and list has allowed ASX to continue expanding what it does and what it provides. ASX is much more than a "stock exchange", as that term was once applied. While the buying and selling of shares remains central, ASX's operations now cover a diverse range of financial products and functions.



ASX also provides post-trade clearing and settlement facilities to ensure that all deals made on ASX markets are carried out strictly in accordance with their terms. For example, in relation to equities, after a transaction has taken place at a given price on ASX's market, it is handled by the Australian Clearing House (ACH), an ASX subsidiary that steps into the middle of a transaction as a central counterparty, becoming the buyer to each seller, and the seller to each buyer. From this position, ACH efficiently schedules all trades for quick, accurate settlement. In doing so, ACH also manages systemic risk – the risk that a default by one party spreads to others. Then another ASX subsidiary, ASX Settlement and Transfer Corporation (ASTC), manages the settlement process, orchestrating immediate electronic payment on the appointed day and simultaneous electronic transfer of legal title to the new owner. Routinely, this whole process is completed within three days of the original share trade.

Under Australian law, these functions can only be performed by licensed operators. Exchanges need a market operator's licence and are required as a condition of their licence to the extent that is reasonably practicable, to "ensure a fair, orderly and transparent market" and to "have adequate arrangements for supervising the market".

Operators of clearing and settlement facilities also need to be licensed. In particular, they have to "do all things necessary to reduce systemic risk" and operate "fair and effective" systems. ASX's licences to conduct these activities constitute a core asset of the company.

To fulfil these obligations, ASX works closely with the Commonwealth Treasury, the corporate regulator, ASIC (Australian Securities and Investments Commission) and the central bank, the Reserve Bank of Australia. While ASX supervises other listed companies, it does not supervise its own compliance with listing rules – this responsibility was given at the time of listing to ASIC.

Over the history of the exchanges, shares have been traded using many different methods including, first, a call system and, subsequently, an "open outcry" system where brokers' bids and offers were recorded on chalkboards. ASX was one of the first exchanges to abandon this system and, in 1987, began conversion to more efficient and capable electronic trading systems, with the introduction of SEATS (Stock Exchange Automated Trading System) for equities and, in 1998, CLICK for options. Through the late 1980s and the 1990s, ASX worked to progressively automate previously paper-based clearing and settlement processes, leading to today's CHES (Clearing House Electronic Subregister System) for securities clearing and settlement and DCS (Derivatives Clearing System) for derivatives clearing.

ASX is also a co-owner of ASX Perpetual Registrars, a separate business that manages share registries for listed companies. (More information can be found at [www.asxperpetual.com.au](http://www.asxperpetual.com.au)).

ASX thus provides services that cover the full range of the investment cycle, from trading through to settlement and CHES registry services on closely integrated systems. This "vertically integrated" structure has proven capable of managing a dramatic expansion in market activity. From the time of ASX's listing, market capitalisation has risen from \$489 billion to \$841 billion in mid-2004. Over the same period, daily equities trading volume increased from some 25,000 trades, worth an average \$950 million, to around 70,000 in 2003/04, worth nearly \$2,500 million. Growth in the options market has been even greater, with volumes more than doubling from an average daily volume of 32,533 contracts six years ago to 76,325 in June 2004.



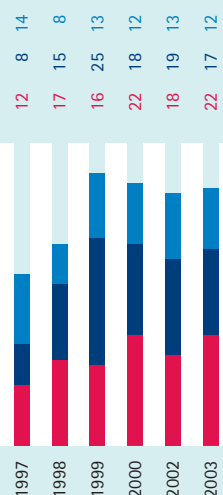
**Australia – a nation of shareholders**  
 ASX released its latest research report into the attitudes and activities of Australian shareowners in February 2004. This study, the tenth that ASX has conducted since 1986, confirmed the unusually high level of share ownership in Australia: 51% of adult Australians own shares either directly or indirectly (that is, through managed funds or self-managed superannuation). The study also showed that the average value of shares invested directly in the sharemarket has increased by 41% since 2000 to almost \$41,000.

The survey was conducted during November 2003 with 2,400 telephone interviews and focus groups across Australia. The study analyses ownership across different age groups, gender, and geographic diversity and examines the different sources of information for investment decisions, the number of holdings in a portfolio and the combined value of investment portfolios. The survey demonstrates the continued strong attachment that Australians have with listed investment, with the great diversity of the investing population increasingly matched with a broad range of products available on the listed market. More information about the study is available on the ASX website.

#### Trend of share ownership

Based on Australians aged 18 and over (percentage)

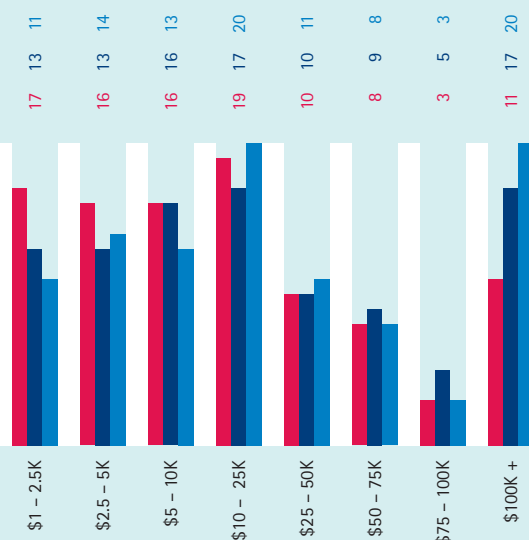
■ Direct only  
 ■ Both direct and indirect  
 ■ Indirect only



#### Value of direct investment in share market

Amount invested in direct investments (percentage)

■ November 2000  
 ■ November 2002  
 ■ November 2003





Helping listed companies raise capital...  
providing opportunities for investors  
to build their wealth...enabling buyers  
and sellers to transact with confidence:  
ASX plays a crucial role in sustaining  
the health of the Australian economy.

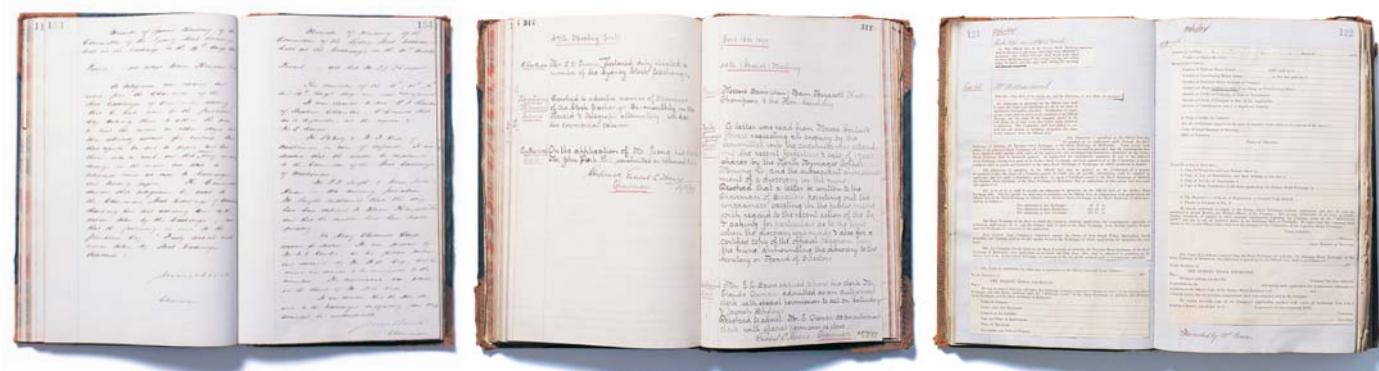


# Confidence at the centre of ASX's mission as market operator

ASX's job is to introduce companies who are seeking capital to investors who are seeking investment opportunities.

Companies need to raise capital at the lowest possible cost; investors need to find investments that best suit their needs for risk and return. Thus, markets, like ASX, are primarily places where investors meet and exchange views on the relative risk and return of different assets; some will be buyers and some sellers. The outcome is that listed assets can be priced accurately and continually – providing a measure of investor sentiment (“is the market up or down?”) that has become a familiar barometer of Australia's economic climate.

ASX's aim to build confidence in the market long pre-dates the legislative and licensing regime that governs Australian exchanges, brokers and other market participants today. Exchanges from their earliest days sought to promote investor activity by imposing rules on the stockbrokers themselves and on the companies whose securities were “listed” for trading.



The philosophy underlying Continuous Disclosure, ASX's principal means of ensuring market integrity, dates back much further than many might think. In the Sydney Stock Exchange Committee Minutes June 1885 to August 1890, it is noted: "...a telegram was received and read from the Chairman of the Stock Exchange of Adelaide stating he had wired to the Junction Company asking them to allow the press to visit the mine on other days but those already allowed for visitors and that reports be sent to papers not less than once a week and that should any important change in the mine take place, to telegraph same at once to Exchanges and leading papers."

The occasional need to employ more direct means also has a long history. Sydney Stock Exchange Committee Meetings, August 1894 to September 1899 state: "...Resolved that a letter be written to the chairman of Directors pointing out the uneasiness in the public mind with regard to the recent action of the Co., and asking for particulars as to the time when the discovery was made and also for a certified copy of the official telegram from the mine announcing the discovery to the Secretary or Board of Directors."

Sydney Stock Exchange General Meetings, June 1899 to January 1924 : "We hereby undertake to supply to the Sydney Stock Exchange...the periodical or special reports and balance sheets of the Company; also prompt notification of all calls, dividends, returns, alterations of capital, or other material information regarding the Company while on the 'OFFICIAL LIST'". To this day, the duty to disclose material information to ASX continues as an embodied principle in the form of the ASX Listing Rules – a contract between ASX and its listed constituents.

With a critical mass of investors and investment products, sound rules and efficient technology, markets can satisfy the needs of all market users. In markets of sufficient scale (depth and liquidity) the cost of capital is lower, the bid-ask spread is narrower and price discovery is more efficient. Those who issue securities – listed companies – and those who invest in them all benefit from depth and liquidity. A stock exchange also benefits as it enjoys improved volumes and transaction revenue. But these outcomes depend on a third, still more valuable, factor – the market's reputation for integrity. As the market operator, ASX has the job of maintaining and promoting the depth, liquidity and integrity of its market. This vital role is only possible when all those who are engaged in the investment process have confidence in the rules and systems provided by the market operator; confidence that:

- they have access to all the information they need to make their decisions;
- the vital process of price discovery delivers the best available price for buyers and sellers;
- the market's rules are clear and fair and properly enforced, so all market users enjoy a level playing field; and
- the transactions they are undertaking will be completed efficiently, fairly and reliably.

It is a mission with many sub-tasks; an over-arching goal achieved by performing a diverse set of closely interrelated functions. ASX's efforts to fulfil this broad role include:

- writing rules for market activity – these are ASX's Market Rules;
- admitting intermediaries (stockbrokers) as market participants permitted to trade on the market;
- ensuring through surveillance that it can monitor the activities and positions of the participants, detect and (together with ASIC) deter aberrant trading practices such as insider trading and market manipulation, and so enforce the Market Rules;
- investigating possible breaches of the Market Rules and presenting appropriate cases for adjudication by Disciplinary Tribunals;
- admitting securities for listing on the market and maintaining rules for them – ASX's Listing Rules;
- ensuring issuers of securities continuously disclose material (price sensitive) information to the market about themselves – this is set out in Listing Rule 3.1;
- establishing and maintaining highly reliable electronic systems to connect all participants, providing efficient price discovery of securities and permitting their trading, clearing and settlement;
- disseminating market information to market users;
- providing education programs to build wider market knowledge and confidence;

- cooperating with ASIC to support market integrity, including referring, for appropriate sanction, cases where ASX believes its rules or the relevant Corporations Act provisions have not been complied with; and
- promoting appropriate policies, nationally and in international forums, to build the depth, liquidity and integrity of capital markets.

Of course none of this takes place in a static world. As new financial products are introduced, new players enter the market, new technologies are developed, and community expectations evolve, exchanges need to be able to respond with appropriate enhancements to their rules and systems. ASX works hard at technological innovation and product diversification to meet evolving customer needs, while also remaining at the forefront of market supervision and the preservation of integrity.

Where market users are confident in the quality of the market, ASX believes they are likely to return to our market with repeat transactions in the future. Fulfilling our obligations to promote a market of high integrity – building a reputation for integrity – is thus aligned with, consistent with, and indeed fundamental to, achieving our objectives as a commercial entity. These are the values conveyed by the ASX Brand. To succeed commercially, ASX must continue to build the reputation of its market, at home and internationally, as a market of high integrity.

"Putting together rules, know-how and technology for transparent trading of assets worth most of the world's GDP is quite a responsibility; to meet that challenge is to assist in building prosperity. Regulated securities exchanges provide solutions by creating greater efficiencies across the public capital markets value chain, and diffusing ever more complex and better quality financial information to support the work of all actors." The Significance of the Exchange Industry, July 2004, World Federation of Exchanges

# ASX's significance in the broader economy

In a way unimaginable to earlier generations of Australians, the Australian economy today has been transformed by two decades of economic reform into a genuine "market" economy. As the most transparent mechanisms for achieving price discovery – and therefore, for more efficient resource allocation – capital markets have emerged as central to the success of the Australian economy.

## Markets and the Australian economy – A virtuous circle



Today, many services formerly provided by the public sector (phone systems, airlines, banking) or by mutual companies (insurance and, in the case of ASX, exchange services) are being provided by companies that are listed, wholly or in part, and that rely on markets for their capital needs. In many cases, their employees have become part-owners, through shareholding.

At the same time, ASX markets have moved to centre stage for the wealth creation plans of millions of Australians. Individual Australians have dramatically changed the way they save and plan for their future. Banks are no longer seen as the only source of capital, nor a block of land the only secure investment. More than half of all adult Australians now own shares, and their average portfolio is diversifying and growing.<sup>1</sup>

This trend has been accelerated and broadened with the introduction of mandatory superannuation contributions for all Australian employees; superannuation saving has become the central pillar of retirement planning for an ageing population. Total superannuation assets exceed \$550 billion – of which nearly half is invested in shares in Australia. New savings are flowing into the superannuation pool at a rapid rate. Member and employer contributions totalled \$58 billion in 2003.

Amid these transformational developments, ASX, as a licensed market operator, has emerged as a crucial player in the allocation of capital in a growing economy, which has itself become more open and competitive.

By helping companies raise capital at an efficient market-determined cost, and by helping investors cost-effectively structure their investment portfolios and manage their risk through diversification, ASX markets make a measurable contribution to the national economy. At the end of June 2004, there were 1,638 companies and other entities listed on ASX, with a combined market capitalisation of around \$840 billion. Equity capital raised during 2003/04 totalled \$38.6 billion; more than 18 million option contracts were traded in 2003/04.

Shares in listed companies continue to provide the core of ASX's market activity and remain the overwhelming favourite market investment for individual Australians. However, ASX's range of exchange-traded products reflects the breadth of the market's impact on the economy as a whole, and on specific industry sectors:

- Many commercial property owners have adopted the listed trust structure to diversify their capital sources – at the same time providing more opportunities for investors; Australia is a leader in the adoption of this form of property funding.
- Many companies have listed interest rate and other securities (hybrids) to raise capital.
- Financial derivatives such as options, warrants and futures provide many companies and individuals with improved means to manage the risk of their investments, providing further bulk to Australian capital markets.

In the words of the World Federation of Exchanges: "By all measures the health of an exchange is vital to a market economy. Exchanges are the symbol of market capitalism. The level of their activities gives an instant shorthand summary of entire nations' socio-economic health."<sup>2</sup>

Indeed, a sort of virtuous cycle operates in equity markets. Improved market activity enhances market efficiency and fosters further growth in activity, as more investors are attracted to the market. In turn, the more liquid and efficient market for capital facilitates capital raising by business for investment purposes. An efficient and vibrant equity market therefore makes a valuable contribution to the efficiency and growth potential of Australian businesses and the economy.

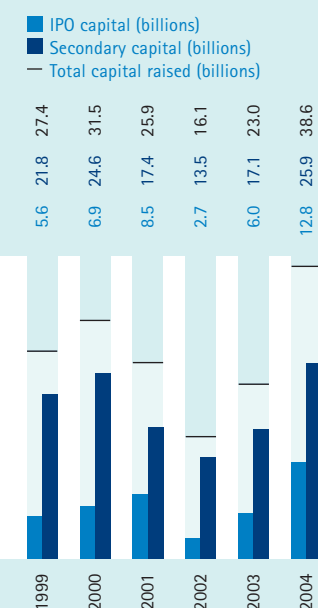
But if it is true that equity exchanges can promote the growth and health of an economy, it is also true that economic decline or stagnation can be marked by decline in market liquidity, setting in motion a negative cycle of reduced participation and market liquidity, with adverse consequences for the cost of capital and for the health of the wider economy.

The challenge is particularly relevant to Australia: for all the recent growth in Australian capital markets, they remain small by the standards of major developed economies and at the edge of relevance to global capital flows. While Australia was ranked as the eighth largest market globally according to the MSCI Global Index, it represented only 2.15% of the global index.

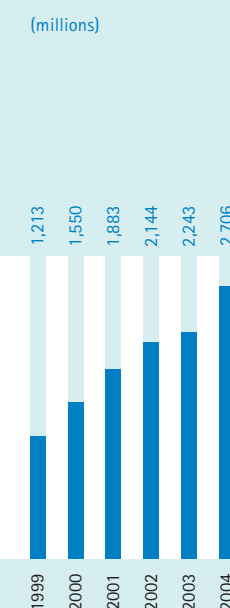
## Market capitalisation



## Capital raising



## Daily average equity turnover



<sup>1</sup> Australian Shareownership Study (2003) ASX.  
<sup>2</sup> The Significance of the Exchange Industry, July 2004, World Federation of Exchanges.

## How are we licensed?

Operating a market or a clearing and settlement facility in Australia requires a licence, issued by the Australian Government under the authority of the Corporations Act. The ASX Group holds three such licences – one market licence and two clearing and settlement facility licences.



Function	Trading	Clearing	Settlement
Licensee	ASX	ACH	ASTC
Activities	Provides trading services for all ASX products	Provides clearing services and central counterparty risk management for all ASX products	Provides settlement processing and asset registration services for all ASX products
Rule book	ASX Market Rules	ACH Clearing Rules	ASTC Settlement Rules

In March 2004, the Government's Financial Services Reform (FSR) process created a single licensing regime for financial sales, advice and dealings in relation to financial products, introduced more consistent and comparable product disclosure requirements and created a single authorisation procedure for financial markets and clearing and settlement facilities.

ASX took the opportunity to streamline and improve its group structure – moving from a product-based structure (built around equities and derivatives) to a functionally-based one (built around trading, clearing and settlement). Thus, when FSR came into effect, ASX's licences were all varied. The three licences now are:

- Australian Market Licence, held by Australian Stock Exchange Limited;<sup>3</sup> and
- Australian Clearing and Settlement Facility Licences, held by Australian Clearing House Pty Ltd (ACH) and ASX Settlement and Transfer Corporation Pty Ltd (ASTC) – both subsidiaries of ASX.<sup>4</sup>

### Market operator's licence

Like any licence, ASX's licence carries obligations as well as rights – obligations about the way ASX and its subsidiaries conduct their operations.

The paramount obligation of ASX's market licence is to operate a market that is "fair, orderly and transparent". The words are not defined in the Corporations Act, but these values collectively imbue ASX's rules and practices. For example:

- In a fair market, all market users are treated equally under the rules, in a manner which accords with requirements published by ASX. For instance, ASX's Market Rules achieve fairness by queuing buy and sell orders according to when they were entered into the system (earlier orders being queued ahead of later orders, assuming the same price) and relative price (higher buy bids and low seller offers being queued ahead of others). Listed companies and broking participants have a right to appeal certain decisions of ASX management where they believe they have been unfairly treated. A fair market is also one in which prices are set through transparent market mechanisms, and in this regard ASX actively deters manipulation of share prices.
- In an orderly market, there are established rules and procedures for buyers and sellers of securities. ASX achieves orderliness, for example, through the various phases of the market such as pre-open, adjust and query phases. Similarly, there is a staggered start to trading of securities.

- In a transparent market, buyers and sellers have access to information they would reasonably require. ASX achieves transparency through, for example, dissemination of company announcements to the market or displaying to the market participants all orders to buy or sell securities.

As a market operator, ASX is also required to have adequate arrangements for supervising the market (including the handling of conflicts between its commercial interests and supervisory responsibilities, and monitoring participants) and to provide "sufficient resources" to operate the market. Approved compensation arrangements must be in place for contingencies such as a broker default.

A further key licence requirement deals with ASX's accountability as a licence holder. ASIC is required to conduct an annual assessment of how well ASX is complying with its obligations as a market licence holder and specifically whether ASX has adequate arrangements for supervising its markets; this document can be found at [www.asic.gov.au](http://www.asic.gov.au). ASX needs to provide an annual regulatory report to ASIC describing how ASX has sought to fulfil its licence obligations and the resources (financial, technological and human) devoted to this task.

ASX's paramount obligation under its licence is to operate a market that is "fair, orderly and transparent". You will not find these words easily defined, or in the Corporations Act, but these values collectively imbue ASX's rules and practices.

The Corporations Act imposes an important control on the structure of ASX, specifying that no one person can own more than 15% of the voting shares of the company, without regulations accepted by both houses of Parliament.

The requirements that apply to ASX as a licensed market operator are set out in Part 7.2 of the Corporations Act.

**Clearing and settlement facility licences**  
ACH and ASTC, as licensed clearing and settlement facilities, must also fulfil a range of responsibilities set out in the Corporations Act. There are two core requirements: to operate a "fair and effective" facility – the complement to the market operator's obligations of fairness, orderliness and transparency – and to take all reasonable steps to minimise systemic risk, an obligation that expressly supports the overall stability of the Australian financial system. "Systemic risk" refers to the possibility that specific events (such as the failure of a system or the collapse of a market participant) can trigger widespread knock-on effects in the nation's financial system, causing loss and damage far beyond those involved in the trigger event.


The Reserve Bank of Australia (RBA) now has responsibility for setting Financial Stability Standards for central counterparties (such as ACH) and settlement systems (such as ASTC).

RBA has published the ten minimum measures that it considers relevant in this respect, covering the legal framework, participation requirements, novation procedures, risk management, system integrity and other measures. Chief among them is the need for ACH to have comprehensive risk control measures in place that provide "a high degree of confidence that, in the event of extreme volatility in relevant markets, the central counterparty will be able to settle all of its obligations in a timely manner".<sup>5</sup>

Alongside the new systemic stability standard, ACH and ASTC also need to continue to meet the previously existing licence requirements spelled out in the Corporations Act. There must also be adequate arrangements for enforcing compliance with operating rules and for conflict handling, and resources sufficient to operate the facilities properly. ACH and ASTC also need to report annually to ASIC on compliance with their licence requirements.

<sup>3</sup> Australian Corporations Act, Part 7.2.  
<sup>4</sup> Australian Corporations Act, Part 7.3.  
<sup>5</sup> "Financial Stability Standards for Central Counterparties and Securities Settlement Facilities". Reserve Bank of Australia, May 2003.





ASX is licensed to operate a market that is fair, orderly and transparent. Our fulfilment of this obligation is crucial, because maintaining the integrity of the market builds confidence for all.

# Why and how does ASX supervise the market?

A market of high integrity – or, in the words of the Corporations Act, a market that is fair, orderly and transparent – inspires confidence among investors, listed companies, brokers, regulators and the broader community.

How is this confidence created? For ASX, the large body of rules and practices that has evolved over the years can be broadly described by reference to three key themes.

Underpinning ASX's supervisory approach and the spirit of its rules and guidance notes, is a commitment by its participants and companies to behaviour that is ethical, honest, cooperative and transparent. ASX relies on education, its closeness to the market and its commitment to develop a culture beyond mere compliance. ASX seeks, above all else, disclosure.

First, ASX has drawn up a foundation of rules to govern market behaviour, and exercises vigilant supervision to encourage compliance with, and to enforce, those rules. Second, ASX acts as one part of a broader structure for regulating the marketplace. Third, ASX has regard to a reasonable investor in conducting its supervisory activities.

## Rules and supervision – ASX as the front-line supervisor

To supervise the market activity of listed companies (as well as trusts) and "participants" (stockbrokers, and clearing and settlement providers), ASX rules cover listing, trading, and clearing and settlement activities. Supported by guidance notes, they outline how business is to be conducted on ASX, regulatory obligations and enforcement and disciplinary processes. The rules are applied consistently and are published on the ASX website.

ASX rules are not "black letter" laws of the Parliament. This point holds the key to much of ASX's supervisory activity. ASX is a "front-line" supervisor – that is, from its vantage point at the hub of the marketplace, ASX is able to appraise emerging issues in a live marketplace and deal with them in realtime. ASX is able to undertake continuous supervision of the market through surveillance monitoring.

ASX's rules have been designed with the intention of promoting certainty about the obligations of listed companies and brokers. They represent a form of contract between ASX and the companies and brokers – specifically with regard to investor protection but without unduly restricting their legitimate commercial operations.

ASX rules sometimes need to be couched in broad terms, sufficient to capture the diversity of activities and circumstances of listed companies. Continuous Disclosure, with its requirement for the provision of "material information", is a case in point.

Underpinning ASX's supervisory approach and the spirit of its rules and guidance notes, is a commitment by its participants and listed constituents to behaviour that is ethical, honest, cooperative and transparent. ASX's approach also relies on education and relationship building, seeking to develop a culture beyond mere compliance.

ASX can undertake prospective supervision (such as promoting the rules, educating the market and deterring non-compliance) and retrospective supervision (such as investigating possible breaches and applying sanctions) although investors always need to bear in mind that ASX can never guarantee participants and listed companies will conduct their business in accordance with ASX rules and the law generally.

ASX seeks, above all else, disclosure. The best market is one where informed decisions can be made by investors. In this sense, information – reliable, timely and relevant – is critical for confident participation in the market. ASX is well equipped to monitor the daily news media and requires the production of information, such as securing an announcement by a company before the start of trading.

## ASX and the wider regulatory structure

Complementing its frontline supervision, ASX has a close cooperative regulatory relationship with ASIC. ASIC regulates and enforces company and financial services laws to protect consumers, investors and creditors. In particular, it approves, monitors and enforces the market-operator system under which ASX provides financial markets – including provision for ASIC to conduct an annual assessment of ASX's performance in fulfilling its licence obligations.

More generally, ASX's rules, developed over many decades, received in 1994 the formal underpinning of the Corporations legislation. ASX rules are only amended after consultation with industry participants and ASIC; once amendments are formally lodged with the government regulator they are subject to a 28-day ministerial disallowance period.

A memorandum of understanding between ASX and ASIC – renewed in July 2004 and available on [www.asx.com.au](http://www.asx.com.au) – summarises the elements of the relationship. The MOU is designed to minimise overlap and increase regulatory cooperation between the two bodies, strengthening the market's confidence that it is supervised by a system that is both robust and flexible, and one able to meet the legitimate needs of business and expectations of investors.

Empirical research assessing exchange success in enhancing market integrity is scarce. Researchers from the Securities Industry Research Council of Asia-Pacific (SIRCA) – a non-profit research organisation specialising in the financial services industry – have endeavoured to fill this gap by a project focussing on data generated by ASX Surveillance referrals between 1989 and 2002. SIRCA's research found that improved detection methods, enhancements to ASX Market Rules, education campaigns and other initiatives have improved broker behaviour and industry compliance over time. This has enhanced the integrity of the Australian equity market. SIRCA's research paper is available from [www.sirca.org.au](http://www.sirca.org.au).

A key objective is the strengthening of market supervision through ASX's statutory obligation to refer "certain matters" to ASIC for investigation and prosecution. These referrals include possible offences relating to market abuse by companies (for example, continuous disclosure and insider trading) and alleged breaches of Market Rules by brokers (such as market manipulation and false and misleading statements). The ASX website publishes the number of annual referrals.

As both a market operator and a listed company, ASX needs as a condition of its licence to have adequate arrangements to handle conflicts between its supervisory and commercial roles. When ASX's commercial objectives give rise to a conflict, potential conflict or perception of conflict, ASIC may itself take the lead role in supervising the market. For example, ASX does not supervise its own behaviour as a listed company – it is a statutory requirement that this role be performed by ASIC.

As an additional layer of security, ASX Supervisory Review (ASXSR) – an independently operating subsidiary of ASX – is tasked with reviewing and reporting to the ASX Board on compliance by the ASX Group with its statutory obligations as a market licensee and clearing and settlement facility licensee under the Corporations Act. ASXSR is specifically tasked with overseeing certain supervisory decisions involving Review Group Entities/Participants – such as a listed company or broker where it is felt there is a possibility of a perceived conflict between ASX's commercial objectives and its ability to supervise that organisation. More information about ASXSR can be found at its website [www.asxsr.com.au](http://www.asxsr.com.au).

## ASX and the "reasonable investor"

In their early years, stock exchanges in Australia and elsewhere were largely operated by and for professional investors. Today, however, more than half of the Australian adult population owns shares. Mandatory superannuation is likely to increase their presence on the sharemarket. It is the investors who have contributed to the growth in depth and liquidity that all market participants now enjoy and whose livelihoods and future wellbeing increasingly depend on the market's efficiency and integrity.

In this environment, ASX has regard to the perspective of a "reasonable investor" in forming views about market rules and operations – not only in terms of protection from various forms of corporate misconduct, but also whole-of-market benefits to investors. The "reasonable investor" is mentioned explicitly in the Listing Rules – for example, in Listing Rule 3.1, companies are required to provide to the market information that a "reasonable investor" would regard as material. The guidance note on Continuous Disclosure provides the following explanation:

"The principles [underlying the Listing Rules] encompass the interests of listed entities, maintenance of investor protection and the need to protect the reputation of the market. By virtue of being publicly listed on the ASX market and having access to the capital that the market provides, an entity has a duty not just to its shareholders, but to investors and the market generally...The interests of a listed entity should not take precedence over the interests of the market, and more specifically the interests of a fully informed market."

## How does ASX supervise listed companies?

A company's entry into the primary market is governed by ASIC and laws relating to its prospectus and other disclosure documents. ASX Listing Rules determine the requirements for the secondary market: that is, listing securities for trading on the sharemarket, including subsequent capital raising – and the conditions under which those securities are traded.

The "ASX-listed" emblem has been adopted by many listed companies since the initiative was launched in June 2003. This emblem is often used by listed companies in their corporate marketing materials, in annual reports, on corporate websites and on business cards and stationery. Out of approximately 1.4 million companies registered in Australia, only those listed on ASX are eligible to use the emblem. For these companies, it is a mark of distinction that promotes clearly and simply that the company is listed and traded on ASX.



ASX's Listing Rules represent a contract of rights and obligations, agreed between the exchange and its listed companies. When a company "goes public" and lists, its owners consent to abide by the Listing Rules, in return for which they enjoy the particular benefits that only a public market can provide. Chief among these is the opportunity to raise capital from the public – and, more broadly, the profile of operating in the public eye, of being able to gain access to the media and to the wider investing public. In return, the company must agree to comply with the Rules for as long as it is listed and to fulfil certain requirements related to the issuing of its securities.

ASX does not prudentially supervise the financial health of listed companies. Rather, the Rules require that companies provide relevant information to allow investors to make their own assessments. Beyond this very important need for transparency, the Rules also describe a wider framework within which certain obligations are imposed on companies and rights are afforded to shareholders.

Through its Listing Rules, ASX requires, for example, a significant number of investors prior to listing to ensure a reasonable prospect of a liquid market in those securities. There must be certain pre-quotations disclosures to ensure that trading is on a reasonably informed basis from the outset. There should be sufficient information from the outset for investors to be informed about the nature of the investment, and Continuous Disclosure will immediately begin building on that knowledge base.

In Australia, the Rules are also given a special position under the law, allowing ASIC, ASX or any person "aggrieved" to apply to the Court to have the Rules enforced if they are not complied with.

Listing Rule 3.1 – better known as Continuous Disclosure – forms the heart of ASX's supervision of listed companies. For investors it is the most important rule, as it aims to provide a fair and equal footing upon which all investment decisions can be made.

Subject to a few exceptions aimed at protecting some classes of confidential information – such as information about incomplete negotiations and trade secrets – a listed entity must immediately tell ASX of any information that may affect the price or value of its securities.

Bolstering this ongoing, real-time commitment, listed companies must give ASX periodic reports about their financial positions and performance. Periodic reports include half-yearly reports and preliminary final reports for all listed companies, quarterly reports for mining exploration companies, and information required by the Corporations Act, such as details about major shareholders or the remuneration of senior executives. Start-up companies listed on the basis of commitments to certain activity (rather than sheer size or previous profitability) also report quarterly on their progress.

All periodic reports are required within specific time frames. In most cases, companies that do not meet these deadlines are suspended from the market.

At times, listed companies may seek relief from specific listing rules where the requirement may inadvertently detract from the Rules' underlying principles. In these cases, ASX may consider waiving the rule – but only where the primacy of market integrity is maintained. All waivers, and the reasons for granting them, are recorded in a register that is provided to ASIC on a monthly basis and is available to the public.

### Surveillance of the market

ASX Surveillance oversees all trading activity in quoted securities to detect and analyse irregularities and anomalies for further investigation, and possible corrective action.

Surveillance gathers public information that may influence trading, such as stockbroker research reports, investment tip sheets, internet chat sites, company-provided information (including market announcements), news media reports and general market intelligence.

Further, through the SOMA (Surveillance Of Market Activity) system, Surveillance monitors trading patterns on a real-time basis and tracks them against other information and intelligence. Inexplicable movement in share prices or trading volume may suggest that sufficient disclosure has not been made, or that only some investors are in possession of material information. It may mean that material information properly withheld from the market has suddenly lost its "confidentiality" and that all investors should be made aware of it. It may also mean that a serious offence such as market manipulation or insider trading is taking place.

ASX often sends "price queries" to companies whose securities have shifted sharply seeking an assurance that the market is fully and appropriately informed of all material information. These queries, and their responses, are usually released so that the market can make its own judgement as to what may be influencing trading.

ASX reserves the right to suspend trading in any company's securities to prevent poorly or partially informed trading in a company's securities. It may make a referral to ASIC if it believes possible offences may have been committed, and supporting data and information will be provided to the regulator to assist in that investigation. In extreme cases ASX may consider delisting the company. While this might certainly provide sanction against those associated with a listed company in breach of the Rules, it would also have the effect of penalising shareholders who might seek to sell their shares in an orderly market while still protecting management from the market's judgement.

The conditions for listing on ASX Minimum standards of quality, size, operations and disclosure must be satisfied.

Sufficient investor interest must be demonstrated to warrant an entity's participation in the market by having its securities quoted.

Securities must be issued in circumstances that are fair to new and existing security holders. Securities must have rights and obligations attaching to them that are fair to new and existing security holders.

Timely disclosure must be made of information that may affect security values or influence investment decisions, and information in which security holders, investors and ASX have a legitimate interest.

Information must be produced according to the highest standards and, where appropriate, enable ready comparison with similar information.

The highest standards of integrity, accountability and responsibility of entities and their officers must be maintained.

Practices must be adopted and pursued which protect the interests of security holders, including ownership interests and the right to vote.

Security holders must be consulted on matters of significance.

Market transactions must be commercially certain.

These ten principles, set out in the introduction to the ASX Listing Rules, outline the basis for ASX's listing requirements and govern and inform ASX's judgement and application of particular decisions on specific rules.



# Continuous Disclosure: How does it work?

Transparency means disclosure. If there is one action that captures ASX's management of a modern market, it is the requirement for disclosure.

The fairest market by and large will be the one with the best quality disclosure – because this delivers, in a usable, accessible and equal form, the information that the "reasonable investor" needs in order to make investment decisions.

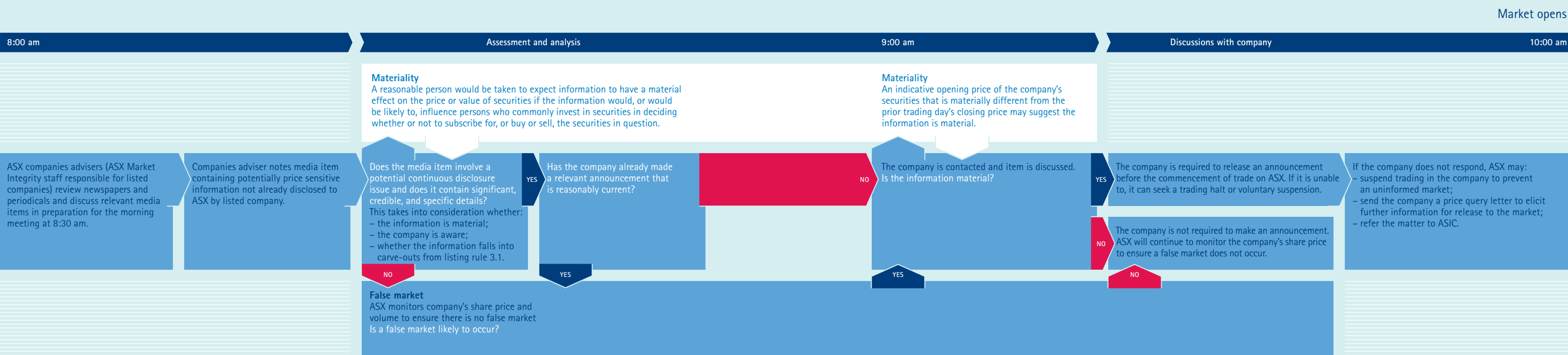
ASX encourages, enables, facilitates and where necessary demands disclosure. Most important, especially given the immediacy and speed of a live market whose currency is information, is the requirement for Continuous Disclosure. In the words of Listing Rule 3.1: "Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information."

Save for a limited number of exceptions – that principally ensure disclosure does not prevent legitimate and appropriate commercial activity – the onus lies with a listed company to demonstrate why disclosure might not be appropriate. As Rule 3.1 makes clear, disclosure must take place except where "a reasonable person would not expect the information to be disclosed".

For most investors, the media remains the most powerful single source of market news. ASX therefore commits time and resources to ensuring that events, developments and commentary reported in the media sit comfortably with what the investing public might already have been expected to know – and to achieving disclosure to the market where necessary to bring about that situation.

Having facilitated and required the disclosure of material information, ASX also makes a significant contribution to disseminating it. Company Announcements are sent to thousands of offices around Australia and overseas electronically – a significant improvement on the pre-SEATS days when announcements were pinned up on a noticeboard in hard copy. These announcements are followed, interpreted and often acted upon by thousands of stockbrokers, journalists, fund managers and other investors on an intra-day basis. They are the heartbeat of the market and, in a continuous disclosure regime, the prime driver of investor sentiment and market direction. Announcements are also provided on the ASX website to provide investors with near real-time access at no cost to them.

Continuous Disclosure in action. ASX's own Share Ownership Study and numerous other surveys have shown that investors track and develop their investment portfolio through the financial media. It is therefore pivotal to market integrity and investor confidence that media and analyst revelations are monitored closely and, where necessary, followed up with additional information. The aim is to achieve a market in which all participants can make their own informed decisions.



## Corporate governance of listed companies

ASX has long concerned itself with issues of corporate behaviour in general, and corporate governance in particular. While most aspects of corporate activity and behaviour are dealt with by legislation – notably in the Corporations Act – ASX's own perspective on governance matters is informed by the emphasis on transparency and fairness.

The Listing Rules are based on the premise that sufficient information should be provided so that investors can form their own view as to a company's performance, prospects and standing. This is achieved through the cumulative effect of Continuous Disclosure and periodic disclosure, which includes financial performance statements and annual reports to shareholders.

The annual report must include such features as the identity of directors and senior management, company contact details, the number of shares on issue, a review of operations and activity, a list of significant shareholders and, since 1996, a description of the company's corporate governance arrangements. In fact, stock exchange interest in governance practices of listed companies, in varying forms and levels of detail, can be traced back to at least 1912.

Significant corporate governance disclosure is therefore neither new nor unusual in the prominence ASX accords it, numbered as it is alongside such aspects as financial performance as a mandatory issue for shareholder consideration. ASX has tended not to prescribe specific measures of acceptable and unacceptable corporate governance, but it has required an annual examination and disclosure of every listed company's arrangements in this regard.

Following a succession of high-profile corporate collapses, predominantly in offshore markets but not confined to them, considerable community concern arose as to whether there were sufficient checks and balances in the Australian regulatory model to cope with poor governance structures and unacceptable corporate behaviour. Also underpinning this concern was a renewed appreciation of the significant role the capital market plays in the national economy, and the fact that more than seven million Australians owned shares.

The American experience with corporate collapses such as Enron and WorldCom had led to the development and passage through the US Congress of quite restrictive legislation, a package of amendments collectively known as "Sarbanes-Oxley" reforms. A number of Australian market participants expressed concern that this American response to a particular series of events might lead to a similar initiative in Australia, locking in mandatory procedures that might add significantly to costs on companies without necessarily improving investor protection or market confidence.

Recognising the need for an industry-wide, credible and sustainable framework for corporate governance, in August 2002 ASX convened the ASX Corporate Governance Council to develop an agreed set of best practice standards for listed companies. The Council identified and developed a series of practices that reflected international best practice and which would enhance the reputation of Australia's capital markets and of Australian companies. Central to the Council's thinking was the recognition that such practices are evolutionary and must be regularly reviewed – and should be integrated into a company's business model.

Recognising the limitations of the American approach, the Council opted for a model that retained sufficient flexibility so as to suit the wide variety of companies listed on ASX. This flexibility was tempered by the accountability gained from requiring companies to explain to investors why an alternative approach is adopted: the "if not, why not?" obligation.

In March 2003, the Council published its ten principles of good corporate governance, supported by 20 best practice recommendations. The Council subsequently appointed an Implementation Review Group, comprising respected senior industry figures, to provide feedback, deliver progress reports and recommend future reforms. The Council's principles and recommendations are guidelines, designed to facilitate an improvement in market efficiency, quality or integrity. Companies retained the freedom to consider any recommendation inappropriate to their own circumstances, and therefore not to be adopted. However, their obligation to disclose against the principles was incorporated into the Listing Rules to ensure that while adherence to a particular standard was not mandatory, reporting against it was. The requirements under this rule came into effect for the 2004 reporting season.

In that way investors could be the judges, and the regulatory system could flexibly respond to legitimate market expectations, without imposing a costly legislative burden on companies and their investors.

The essential corporate governance principles state that a company should:

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| <p>1 Lay solid foundations for management and oversight<br/>Recognise and publish the respective roles and responsibilities of board and management.</p>             | <p>6 Respect the rights of shareholders<br/>Respect the rights of shareholders and facilitate the effective exercise of those rights.</p>   |
| <p>2 Structure the board to add value<br/>Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.</p> | <p>7 Recognise and manage risk<br/>Establish a sound system of risk oversight and management and internal control.</p>  |
| <p>3 Promote ethical and responsible decision-making<br/>Actively promote ethical and responsible decision-making.</p>   | <p>8 Encourage enhanced performance<br/>Fairly review and actively encourage enhanced board and management effectiveness.</p>   |
| <p>4 Safeguard integrity in financial reporting<br/>Have a structure to independently verify and safeguard the integrity of the company's financial reporting.</p>   | <p>9 Remunerate fairly and responsibly<br/>Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined.</p> |
| <p>5 Make timely and balanced disclosure<br/>Promote timely and balanced disclosure of all material matters concerning the company.</p>                              | <p>10 Recognise the legitimate interests of stakeholders<br/>Recognise legal and other obligations to all legitimate stakeholders.</p>  |

**Members of the ASX Corporate Governance Council**  
ASX Corporate Governance Council brings together 21 groups from disparate business backgrounds, each carrying the varying aims and priorities that accompany those constituencies. Each Council member offers valuable guidance and information specific to their constituencies and industry.

Australian Stock Exchange (ASX) (Chair)  
Association of Superannuation Funds of Australia Limited (ASFA)  
Australasian Investor Relations Association (AIRA)  
Australian Council of Superannuation Investors (ACSI)  
Australian Institute of Company Directors (AICD)  
Australian Institute of Superannuation Trustees (AIST)  
Australian Shareholders Association (ASA)  
Business Council of Australia (BCA)  
Chartered Secretaries Australia  
CPA Australia  
Group of 100  
Institute of Actuaries of Australia  
Institute of Chartered Accountants in Australia (ICAA)  
Institute of Internal Auditors Australia (IIA-Australia)  
International Banks and Securities Association of Australia (IBSA)  
Investment and Financial Services Association (IFSA)  
Law Council of Australia  
National Institute of Accountants (NIA)  
Property Council of Australia  
Securities and Derivatives Industry Association (SDIA)  
Securities Institute of Australia (SIA)

## Supervision of ASX market participants and clearing and settlement participants

While "market participant" is sometimes narrowly taken to mean "stockbroker", in today's market it covers a range of different activities performed by different organisations or people.

Participants can join the market as a trading-only participant making use of a third party to clear and settle their own transactions, as a clearing-only participant clearing for other participants, or as a trading, clearing and settlement participant who trades, clears and settles on their own behalf.

ASX's markets and CS facilities do not limit access to a finite number of participants – as is the case in some exchanges elsewhere around the world – but rather, access is allowed as long as certain entry criteria are satisfied. These requirements are in place to ensure that high levels of efficiency, integrity, operational capacity and quality management are met.

ASX supervises its markets to ensure that participants operate and compete on a common basis, where their rules are understood by each other, able to be viewed and favourably judged by external parties with a legitimate interest in the fair operation of the market.

The ASX Market Rules set out requirements concerning the operations and behaviour of market participants. They also prescribe recordkeeping, accounts management and auditing, reporting obligations, the broker's rights in the case of a client default, and rules relating to client priority in trading.

In keeping with the wider mandate of working with the industry to achieve the best result, ASX conducts self-assessment and inspection programs of market participant organisations, and provides various education activities.

The Investigations and Enforcement team work closely with the Surveillance team and others in ASX, and with ASIC, to examine matters warranting investigation. As part of this effort, they may interview participants and their employees, inspect their records and examine the behaviour of brokers and their compliance with the Rules.

In instances where it appears that a participant may have breached the Rules, the matter may be referred to the Disciplinary Tribunal for adjudication.

The Tribunal is designed on a peer-assessment structure, consisting of three respected figures in the broking industry chosen, on the basis of their independence and relevant expertise, from a wider panel of industry figures. It receives the support of the industry, which recognises the importance of having its behaviour viewed and judged by those who have worked within the same Market Rules themselves.

### Clearing and settlement – supervision

The clearing and settlement facilities provided by ASX constitute a key component of the overall infrastructure of Australian securities markets. As for any infrastructure, successful operation of the clearing and settlement infrastructure for the mutual benefit of all users depends upon users complying with a set of rules, and in return enjoying the benefits of certain rights acquired under those rules.

Analogy can be drawn with rules governing the road infrastructure in Australia. For example, these rules require users to drive on the left-hand side. But they also recognise that special circumstances may arise which make it sensible to waive that requirement; for example, to expedite journeys for emergency vehicles. Unless this and other rules of the road infrastructure are broadly complied with, chaos would prevail, with consequential high costs in terms of damage to persons and property. So it is with the clearing and settlement infrastructure.

The key rules governing clearing and settlement are the ACH Clearing Rules, and the ASTC Settlement Rules, augmented by some provisions in the ASX Listing Rules which also play a part in achieving orderly and efficient operation of the settlement infrastructure.

ACH and ASTC have a range of measures, mandated under their respective rules, through which they supervise the conduct of organisations that use the infrastructure. Examples of some key rules governing the clearing and settlement infrastructure are:

- criteria for admitting participants and permitting continued participation, including, for example, business integrity requirements, management skills and experience requirements, technical interfacing requirements and business continuity requirements;
- financial resource requirements, which require participants to maintain a level of capital that is commensurate with their risks, as calculated in accordance with the ACH Rules;
- rights of ACH to impose limits on a participant's exposure to derivatives through position limits;
- obligations of participants to provide cash or collateral to cover margin obligations;
- basic standards in contractual arrangements between participants and their clients; and
- rights of ACH to require participants to contribute to a clearing fund.

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ASX seeks to ensure that participants operate and compete on a common basis, where their rules are understood by each other, able to be viewed and favourably judged by external parties with a legitimate interest in the fair operation of the market. And this occurs against a backdrop in which ASX has needed to upgrade its infrastructure to accommodate a more than tenfold increase in the number of transactions settled each day.

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In monitoring compliance, a crucial supervisory discipline for ACH is to constantly check the exposure of clearing house participants to market fluctuations, in the light of their open (i.e. unsettled) positions against the clearing house as the central counterparty. There are two main threads to this risk management – continuous assessment of real risks based on actual positions and market movements, and analysis of "stress test" risk based on actual positions and an abnormal market movement (for example, an intra-day 25% fall in the market or a 10% rise in the market). ACH may require participants, in response to these risk assessments, to increase their capital or provide additional margin. Apart from assessing the "what if" impact on particular participants, the stress test provides a measure of the risk of exposure of the clearing house itself under extreme market conditions in the event that one or more of its participants defaulted on its settlement obligations.

Many of the ASTC Settlement Rules require settlement participants and issuers, usually through their share registry service providers, to perform various functions within defined time periods or in accordance with cut-off times for the settlement process. The CHES computer system itself enforces rules of this type through its processing schedule.

To help safeguard both ACH's interest and the interests of retail investors – who may, for example, have securities pledged to, and hence sponsored by, a margin lending organisation – the ASTC Rules require that any participant which is not subject to a prudential supervisory regime must lodge a \$500,000 settlement performance bond, and, if such a participant also offers sponsorship to investors, it must also lodge a \$500,000 sponsorship bond.

Just as the provider of road infrastructure needs from time to time to alleviate congestion or improve safety by undertaking routine maintenance or major rebuilding work, so the provider of the clearing and settlement infrastructure has the responsibility to maintain and improve the level of service and to alleviate risks. Over the past decade, ASX has upgraded its infrastructure to accommodate a more than tenfold increase in the number of transactions settled each day.

Other enhancements which serve both to expedite settlement and reduce risks in the settlement of equities transactions include elimination of certificated holdings, delivery-versus-payment settlement, electronic transfers, and the adoption of a short, fixed period settlement discipline – now trade date plus three business days.





To support Australia's rapidly growing capital market, and to help develop the opportunities presented by the global marketplace, ASX provides efficient, reliable and accessible technology. And because an informed investor is a confident investor, ASX provides practical and responsible education and information services.

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## Extending the market

ASX's embrace and development of, and then reliance on technology has not only followed its evolution as a fully fledged national exchange, but in many ways has been prompted by it. Indeed, it was technological advancement that enabled the Australian Stock Exchange – a national organisation – to come into being.

Prior to 1987, Australia's six city-based stock exchanges operated on a market technology as basic as it was time-honoured: the aptly named "open outcry" system, whereby brokers called out their bids and offers, with sales recorded on chalkboards. However, the need to combine their respective markets meant a solution had to be found that enabled the exchanges in all six states to participate equally.

The only way this could be achieved was by embracing electronic trading, despite the industry's scepticism of the still-nascent technology's value. The debut of SEATS in October 1987 was not aided by its coincidence with the global stock market crash – but it successfully accommodated the hectic trading, in which prices fell by an average 25%. Systems capacity-related issues could not be allowed to stymie or cloud the market's activity – a philosophy that remains in place to this day.

SEATS had been conceived, developed and built in-house by ASX. In the same vein, ASX adopted electronic clearing and settlement in 1994, via the proprietary CHES system – replacing paper-based systems, with all their attendant delays and inaccuracies, with simpler, faster and more accurate processing of trades along with more sophisticated systemic risk management.

The transformative powers unleashed by this new technology continued to be felt in subsequent years. Again, the change spread far further, and deeper, than just the initial, practical challenge.

In the past, floor-traded markets had been typically established, owned and operated by the broking community. Brokers conducted transactions face-to-face, and the physical limitation of a trading floor underpinned the concepts of limited access, membership and control through mutual ownership.

That changed with technology. Transactions could be executed from afar and the physical dimensions of a trading floor became redundant and as a result, the trading floor no longer existed as such. Access was increased; transparency was improved through making all bids and offers visible for all securities, which encouraged pricing spreads to shrink to within a few cents; and all market participants were treated with equality of access.

Through this process, the new technology facilitated not only the creation of the national Australian exchange but also the exchange's subsequent historic decision to demutualise and list on its own market.

This same technological evolution has proved a major tool in building the integrity of the Australian market, and with it confidence among investors. A national electronic trading system means that investors across Australia have identical access to the prices and information generated on the exchange. Trading on ASX places no premium on proximity, and no discount on distance.

ASX electronic markets provide investors with a wealth of information: not just current pricing but also full depth of bids and offers for each stock; company announcements released to the market are accessible by all investors at the same time.

ASX's own SOMA market surveillance system can monitor in real-time for aberrant, perhaps unlawful, activity that may signify an unsafe market, and prompt an appropriate corrective, and potentially punitive, response.

The reliability and efficiency of ASX's technology platform underpins ASX's ability to operate fair, orderly and transparent markets. The SEATS and CLICK trading systems, SOMA, and other critical ASX systems routinely operate at 99%+ uptime, with the settlement system providing very low fail rates but offering practical certainty even in the event of a delivery failure, where virtually all fails are fixed within a day. This underlying, systemic reliability is readily observable via the ASX website, which provides 24x7 access to all investors.

On the busiest of trading days, with the number of equities transactions surpassing 100,000 daily and at least as many options contracts exchanged, ASX systems easily perform within capacity. For every increase in market accessibility, there has been a corresponding increase in the market's appeal, and with this a need to further boost system capacity. This trend can only continue.

Lastly, systemic improvement and reliability is only as good as its performance in difficult circumstances. Systems can fail – via external disruption, mechanical failure, human intervention or error. ASX has invested considerable resources and effort in establishing the best possible back-up systems and support readiness. Not just a responsibility as a market operator, ASX views this as a central plank in the platform upon which lies at the heart of its markets: justified investor confidence.



**Promoting the Australian market in a global financial industry**  
In an increasingly global financial marketplace, ASX seeks to contribute to the international expansion of the Australian financial market – through providing opportunities both for Australian investors to diversify their portfolio through access to international markets, and to promote the attractiveness of the Australian marketplace for foreign investors and issuers.

Technology plays an important part here. ASX has built a new trading system, ASX WorldLink, to facilitate cost-effective trading, settlement and holding by Australian investors of securities traded in an overseas market, and similarly efficient trading, settlement and holding of ASX quoted securities by overseas investors.

ASX WorldLink currently provides trading to and from Singapore, and one-way trading into the United States. Looking ahead, ASX's new integrated trading system CLICK XT is also being adopted by the Singapore Exchange, opening up further opportunities beyond the existing links between the two exchanges.

ASX has long embraced the concept of global trading, not least in readiness for a time in which investors trade in markets the world over. That time is now, but it was with this in mind that ASX decided in 2000 to move towards market indices that could be as readily understood and followed in New York or London as Sydney and Perth. Therefore we entered into a long-term arrangement with Standard & Poor's, the world's leading index company, to manage our indices. Global capital managers look for the best returns, as they must, and it is through the S&P indices that Australian companies and other investment products remain visible and investible to them.

ASX is also an active member of the major multinational exchange organisations: the World Federation of Exchanges, the East Asian and Oceanian Stock Exchange Federation (EAOSSEF) and the International Options Markets Association (IOMA). ASX has served on the board of the WFE since 2002 and ASX's Deputy CEO, Colin Scully, is currently the President of IOMA. ASX is also a leading member of CCP 12, which brings together the major global central counterparties.

Bilaterally, ASX has signed memoranda of understanding with many exchanges in its region, including Shanghai, Shenzhen, Hong Kong, Korea, Malaysia, Singapore, Taiwan and Tokyo. These MOUs provide for regular exchanges of information and, at times, staff secondments.



## Creating an informed and educated market

One of the most effective ways of building confidence in the market is to provide quality information about it and quality training about how to participate in it. A well informed investor will be more likely to trade with confidence and to understand the appropriate levels of risks.

### Feedback on ASX classes

"Excellent overview – raised my level of awareness of the intricacies of investment. Presenter – Brilliant, interaction with the class was excellent. Very informative and easy to understand. It filled a lot of gaps in my knowledge."

While attention has tended to focus on appropriate disclosure to the market by listed companies, ASX also helps investors become informed about the market. With individuals taking greater responsibility for their own wealth creation and retirement planning, education about investing is even more important and ASX believes it can make an important contribution.

Considerable resources are committed to this objective through a range of activities. These include a comprehensive website; responsible, accessible investor education; world-leading access to company announcements and a dedicated customer service centre.

### Listening to an expert

Responsible education on investing in the sharemarket has been provided since ASX was established and, through the forerunner state exchanges, for many decades prior to that. The last few years have seen many groups offering sharemarket education – some making extravagant promises and with attendance fees to match. In contrast, the ASX program has been consistent in offering inexpensive education that seeks to convey both the risks and rewards of investing.

Classes are offered in all the major products traded on ASX markets. Four classes deal with shares, starting with the beginner level "Starting in the Sharemarket" and proceeding to "Tracking your Sharemarket Investment", "Analysing and Selecting Shares", and "Developing your Investment Portfolio". For more advanced investors, "Active Investing" has been introduced. In derivatives, ASX offers "Getting Started in Options", "Advancing in Options", "Getting Started in Instalment and Trading Warrants", "Unlocking Wealth and Short Term Strategies using Warrants"; "Using Instalments in Self-Managed Funds", and "The Mechanics behind Trading Warrants". In addition ASX offers "Investing in Overseas Markets" and "Getting Started in Income Securities".

Experts employed by ASX and industry professionals selected by ASX deliver these face-to-face classes, which are held in evenings and at weekends and include comprehensive notes. For those outside the capital cities, "distance education" is available via self-learning packs. In 2003/04, ASX educated over 7,500 people across Australia via these face-to-face and self-learning classes.

### Education for all Australians

As a national exchange, ASX is mindful of its stakeholders across Australia and has sought to broaden access to its education programs. Most of ASX's face-to-face education classes are also available online via ASX's website – free of charge.

ASX has over the last two years conducted an education roadshow throughout regional Australia, supported by Telstra CountryWide and, more recently, CommSec. This involves an evening seminar outlining the basics of sharemarket investing, with tips on where to find more information and how to contact a broker.

### At your own pace, in your own time

The internet has been a boon to ASX in its aim to encourage people to become informed about the market. The ASX website [www.asx.com.au](http://www.asx.com.au) is available 24 hours a day, attracting over 400,000 unique users each month from around Australia and indeed from as far afield as Uzbekistan and Namibia.

ASX does not seek to provide a full-scale research service for investors – a role better performed by brokers, data vendors and others. However, ASX does have an interest in providing investors with access to the material information they need to make informed investment decisions.

This is provided free of charge on [www.asx.com.au](http://www.asx.com.au), and includes share prices (on a 20-minute delay), dividends, charting and company announcements. Announcements lodged with ASX by listed companies under the continuous disclosure rules are made available on the website, in full, within moments of release.

An archive of more than half a million company announcements dating back to 1998 is also available free-of-charge. Announcements also can be tracked for delisted companies and companies that have changed their name or ASX code. Beyond this, comprehensive archives of ASX announcements for all listed companies are available free of charge in State Libraries around the country – online or through an ASX-provided collection of CD-ROM discs.

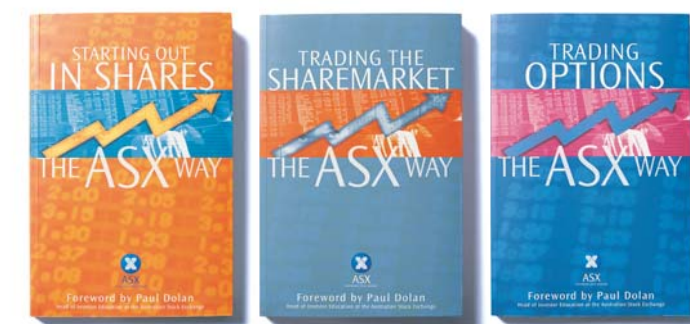
Alongside this market information, ASX has a comprehensive range of free online education classes, downloadable brochures and course notes as well as interactive exercises. Over the last financial year 55,000 have enrolled in the online classes.

A special feature of the website is the MyASX sector which provides dedicated information services for individual investors. By registering on the website investors can receive e-newsletters, set up watchlists and enrol in online education classes and trading simulations.

### ASX website

ASX's public website is located at [www.asx.com.au](http://www.asx.com.au). The website features near real-time announcements for ASX listed companies and 20-minute delayed price data for quoted securities. It also includes:

- upcoming floats;
- market news;
- broker referral service;
- sharemarket games;
- access to online classes and newsletters;
- investor centre and personalised watch lists;
- information about ASX and its services;
- ASX market announcements and press releases; and
- the ASX annual report.



Written by ASX's expert education team, "The ASX Way" is a new, three-part series for investors who want accurate and objective information straight from the source. The first of the series, "Starting Out in Shares", is aimed at beginners in the sharemarket, while books two and three are written for those looking to develop more sophisticated strategies in their approach to share investments and options trading.



# Encouraging the next generation of investors

More than 20 years ago, the then Perth Stock Exchange embarked on an ambitious new venture to promote investing: a sharemarket game for school students. In its early days the game was all based on paper, with students mailing in their investment orders. Over the years, however, the concept has been expanded, upgraded and taken online to the point where ASX believes it to be the best of its kind in the world.

## Customer Service Centre

ASX's National Customer Service Call Centre handles a steady stream of phone and email enquiries. Among other things, the Call Centre provides referrals to stockbrokers, takes enquiries and enrolments for ASX courses, and answers a range of questions about the sharemarket and listed companies. The Call Centre is available to members of the public for the cost of a local call on 1300 300 279 or fax (61 2) 9227 0885.



ASX conducts many of its investor classes "in-house", including in the ASX Auditorium, Exchange Square, Sydney. Classes are led by market experts and are offered over all the major products traded on ASX.



Students and teacher with a 100-year chart of the All Ords at a recent awards ceremony for the ASX Schools Sharemarket Game.



In Sydney's Exchange Square, the wallboards and video wall – just one graphical representation of the activity and colour of Australia's primary equity market. The boards and "ticker" remain a popular primary source for share price and news updates for many investors.

The ASX Schools Sharemarket game provides a safe and informative online trading experience for students where they can invest a hypothetical \$50,000 in listed companies over ten weeks. Consistent with the community focus on financial literacy, ASX believes that sharemarket games help young people by assisting them in managing their future. More than 75,000 secondary school students participated in the game from across Australia in 2004, representing over 50% of secondary schools in the country.

The feedback received by both students and teachers of the most recent game suggests that they see the Game as a great tool to learn about investing in shares:

"I would just like to say that this game is awesome! Not only is it fun, but also it is educational. Over the past few weeks, I have learnt a lot more than any textbook has to offer. You get an urge to log on and see how you are doing all the time. I think that students all around the country should get the opportunity to take part in this. I applaud the founder of the game. Congratulations".

"Am using this game as a major project within the year 10 mathematics syllabus in the school. Students' reactions have been exceptional with many questions about the stock market and how it works, when to sell and what to buy. Directions from myself allow them to research the companies and look for indicators of share price rises or falls. It really is a good teaching tool showing mathematics in real life and introducing students to the stock exchange. The idea of 'real life' trading is really a very good idea".

Financial literacy studies have emphasised that school-based education must meet the needs of school teachers. Teachers provided feedback to ASX that more teaching resources would help them convey the concepts that underpin investment decisions. To meet this need ASX developed an online teachers resource guide that can be used by teachers or independently by students. This resource includes ready to print lessons on the sharemarket, a guide to using the ASX website as well as information on teacher professional development.

Alongside the schools game, ASX runs a game for members of the general public – again, with the intention of providing a way to learn more about investing and experience trading before committing "real money" to the market. Approximately 35,000 Australians registered to play the ASX Public Sharemarket Game in 2004.

## Calculators and tools

The ASX website provides a range of sophisticated calculators and strategy-modelling tools to assist investors – particularly those interested in the derivatives products traded on ASX. Tools to calculate fair value or likely margin obligations, and software to work out the risk profile of particular strategies – formerly the domain of professional investors and at considerable cost – are now available via ASX free of charge.

The ASX options and warrants markets are world leaders in many respects and ASX actively encourages product innovation in the derivatives area. Our commitment to the ASX derivatives market is matched by a commitment to responsible education about these products and the provision of practical calculators and tools to assist people in their investment decisions.

## Education for the development of the financial industry

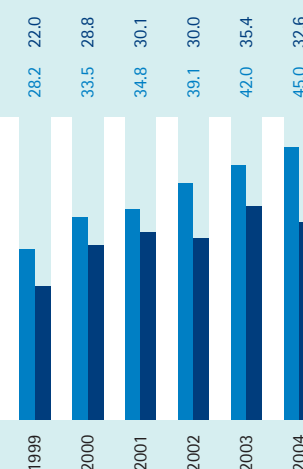
ASX's Investor Education programs have received an invaluable boost from the Financial Industry Development Account (FIDA) of the National Guarantee Fund, the exchange compensation fund administered by the Securities Exchanges and Guarantee Corporation (SEGC).

Under the Corporations Act, and with the approval of the relevant Commonwealth Minister, FIDA funding can be used for non-commercial, public benefit purposes that relate to the development of the financial industry – such as face-to-face and online education classes and related information services provided by ASX.

ASX provides six-monthly reports to Treasury on its application of FIDA funding. More information about FIDA and the SEGC can be found in the SEGC Annual Report at [www.segc.com.au](http://www.segc.com.au).

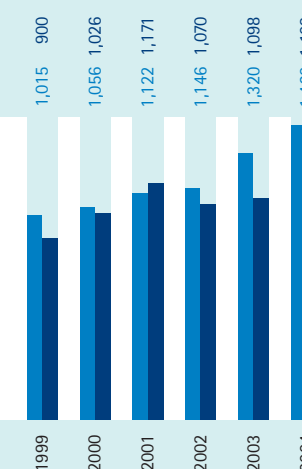
## Number of students participating

■ Game 1 (thousands)  
■ Game 2 (thousands)



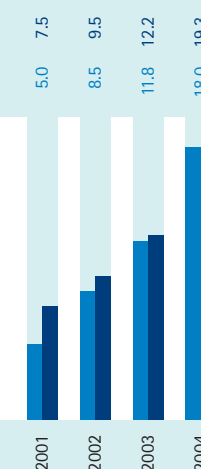
## Number of schools participating

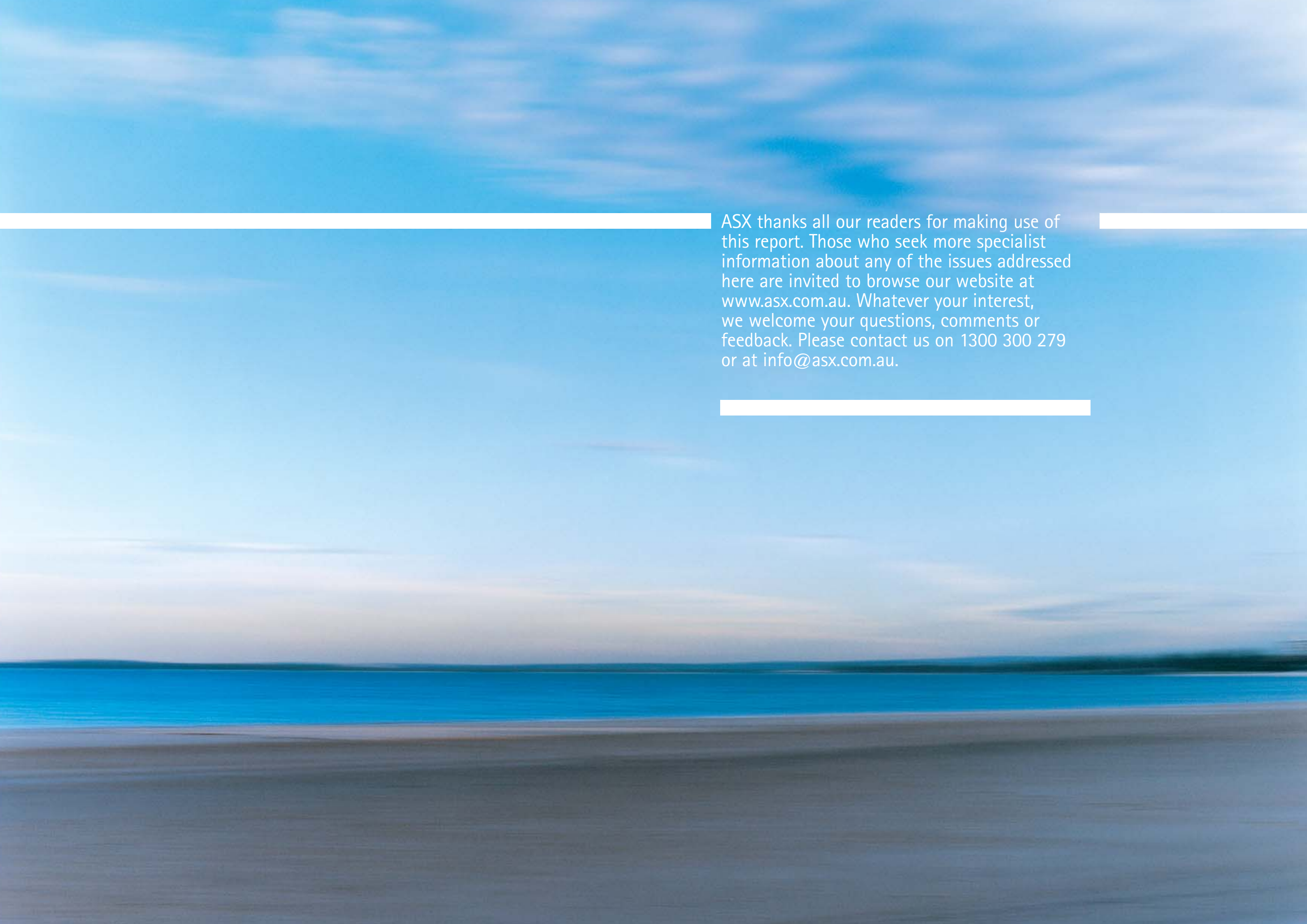
■ Game 1  
■ Game 2



## Public game participants

■ Game 1 (thousands)  
■ Game 2 (thousands)





ASX thanks all our readers for making use of this report. Those who seek more specialist information about any of the issues addressed here are invited to browse our website at [www.asx.com.au](http://www.asx.com.au). Whatever your interest, we welcome your questions, comments or feedback. Please contact us on 1300 300 279 or at [info@asx.com.au](mailto:info@asx.com.au).



# Glossary

A comprehensive glossary of terms can be found on the ASX website, [www.asx.com.au](http://www.asx.com.au).

**Australian Clearing House Pty Ltd (ACH)**  
The Australian Clearing House Pty Ltd, the subsidiary of ASX that clears options and futures traded on ASX.

**All Ordinaries (All Ords)**  
The index is made up of the weighted share prices of the top 500 Australian companies. Established by ASX at 500 points in January 1980, it is the best known measure of the overall performance of the Australian sharemarket. The companies are weighted according to their size in terms of market capitalisation (total market value of a company's shares).

**All Ordinaries Accumulation Index**  
An index that takes into account both capital appreciation and dividends as a return on the companies in the All Ordinaries index.

**Annual Report**  
In the context of the Australian sharemarket, the annual report is a financial report or statement issued by a publicly listed company to its shareholders. The annual report contains a statement of financial performance, a statement of financial position, a statement of cash flow, as well as notice of the Annual General Meeting (AGM) and business resolutions to be discussed.

**ASX code**  
A unique, usually three-letter code used by the Australian Stock Exchange (ASX) to identify listed companies. See listed company.

**ASX WorldLink**  
ASX WorldLink is the brand name of the service provided by ASX International Services Pty Ltd. The service allows an investor to invest in Participating International Securities listed on international markets in Australian dollars through an Australian broker.

**Australian Securities and Investments Commission (ASIC)**  
The Government body responsible for regulating and enforcing company and financial services laws to protect consumers, investors and creditors.

**ASTC**  
ASX Settlement and Transfer Corporation, a wholly owned subsidiary of ASX that operates its clearing and settlement system CHES.

**Board of directors**  
An elected body or persons formed to control the planning and implementation of corporate objectives.

**CHES**  
ASX's Clearing House Electronic Sub-Register System that provides the central register for electronic transfer of share ownership.

**CHES subregister**  
That part of an entity's register for a class of Approved Financial Products that is administered by ASTC and records uncertificated holdings of Financial Products in that class. Note: The register may be of shares, options, managed investments or other financial products that are Approved Financial Products, including CDIs which are units of beneficial ownership issued over Principal Financial Products.

**Company Announcements Office**  
The means by which ASX processes company announcements and releases them to the wider market. Once the announcement provided by the company has been disseminated over the company announcements platform, the market is deemed "informed".

**Corporations Act**  
A national scheme of legislation dealing with the regulation of companies and the securities and futures industries.

**Directors**  
Persons elected by shareholders who are responsible for the implementation of corporate objectives.

**Entity**  
Australian Accounting Standard AASB 1029 says that an entity is any legal, administrative or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives.

**Exchange traded options (ETOs)**  
Option contracts which are bought and sold on the options market operated by ASX.

**Floater**  
The initial raising of capital by public subscription to securities, such as shares offered on the sharemarket for the first time.

**Fund manager**  
The individual or organisation in charge of investing funds on behalf of a financial institution.

**Futures contract**  
A legally binding agreement to buy or sell a security, commodity or financial instrument at a fixed price on a specified date in the future.

**Index**  
A measure of a change in value of underlying securities. For example the All Ordinaries Index.

**Liquidity**  
Being able to convert assets into cash easily, quickly and with little or no loss of capital. A liquid market is a market with enough participants to make buying and selling easy.

**Listed company**  
A company which has agreed to abide by ASX Listing Rules so that its shares can be bought and sold on ASX.

**Listing Rules**  
The ASX Listing Rules govern the procedures and behaviour of all ASX listed companies (see listed company) and listed trusts.

Only public companies and public trusts are permitted to be listed on ASX. A public company (or trust) is one in which any member of the general public can acquire shares (or units) and there are no restrictions on the maximum number of shareholders (or unitholders).

In addition to prescribing pre-requisites for listing, the Listing Rules require that listed companies and trusts report announcements to ASX to keep the market informed of their activities and report profit results and other financial information within specific deadlines.

**Market participants**  
Organisations that meet ASX's requirements are recognised as Market Participants although commonly referred to as "stockbroking organisations". More than 80 are currently active, many with branches throughout Australia.

**Market Rules**  
The ASX Market Rules govern the operations and behaviour of Market Participants of ASX and Affiliates.

The Market Rules also set out the requirements to become a Market Participant (commonly referred to as "stockbroking organisations"),

The Rules also set out the requirements to become a Participating Organisation (commonly referred to as "stockbroking organisations") and an Affiliate.

The ASTC Settlement Rules govern the operation of CHES, the electronic transfer and settlement system, and the CHES subregister.

**Materiality**  
A reasonable person would be taken to expect information to have a "material" effect on the price or value of securities if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether or not to subscribe for, or buy or sell, the securities in question.

**Option**  
An option is a contract between two parties giving the taker (buyer) the right, but not the obligation, to buy or sell an underlying asset at a particular price on or before a particular date.

**Prospectus**  
The document issued by a company or fund setting out the terms of its public equity issue or debt raising. This provides the background and financial and management status of the company or fund, subject to the requirements of the ASX Listing Rules and the Corporations Act.

**SEATS**  
The stock exchange's automated trading system provided for the trading of securities on ASX.

**Share registry**  
An organisation that, on behalf of a company, records changes in share ownership, issues share holding statements, and makes adjustments for dividend payments, bonus and rights issues.

**Shares**  
Shares represent part-ownership in a company. They can be ordinary shares, preference shares or partly-paid (contributing) shares.

**Trading halt**  
An interruption to trading at the request of a listed company that is not a suspension from quotation.

**Warrants**  
A financial instrument issued by a bank or other financial institution, which is traded on ASX's market. Warrants may be issued over securities such as shares in a company, a currency, an index or a commodity.

# Directory

**ASX around Australia**  
**Sydney**  
Exchange Centre  
20 Bridge Street  
Sydney NSW 2000  
Telephone (61 2) 9227 0000  
Facsimile (61 2) 9227 0885

**Adelaide**  
Level 19  
91 King William Street  
Adelaide SA 5000  
Telephone (61 8) 8216 5000  
Facsimile (61 8) 8216 5098

**Brisbane**  
Riverside Centre  
Level 5, 123 Eagle Street  
Brisbane QLD 4000  
Telephone (61 7) 3835 4000  
Facsimile (61 7) 3835 1004

**Hobart**  
AMP Building  
Level 12, 86 Collins Street  
Hobart TAS 7000  
Telephone (61 3) 6234 7333  
Facsimile (61 3) 6234 3922

**Melbourne**  
Stock Exchange Centre  
Level 3, 530 Collins Street  
Melbourne VIC 3000  
Telephone (61 3) 9617 8611  
Facsimile (61 3) 9614 0575

**Perth**  
Exchange Plaza  
2 The Esplanade  
Perth WA 6000  
Telephone (61 8) 9224 0000  
Facsimile (61 8) 9221 2020

**Share registry**  
ASX Perpetual  
Registrars Limited  
Level 8, 580 George Street  
Sydney NSW 2000  
Telephone (61 2) 8280 7111  
Facsimile (61 2) 9287 0303  
Internet [www.asxperpetual.com.au](http://www.asxperpetual.com.au)

**Auditor**  
KPMG  
**ASX on the internet**  
[www.asx.com.au](http://www.asx.com.au)  
Email: [info@asx.com.au](mailto:info@asx.com.au)

**ASX by phone**  
Customer Service:  
1300 300 279  
for the cost of a local call  
from anywhere in Australia

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The ASX Report to Shareholders 2003/04, the companion to this report, was released in August 2004 and is available at [www.asx.com.au](http://www.asx.com.au) or by phoning 1300 300 279





