



ASX

AUSTRALIAN STOCK EXCHANGE

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Ms Julia Morris
Committee Secretary
Joint Standing Committee on Treaties
Department of House of Representatives
Parliament House
CANBERRA ACT 2600
AUSTRALIA

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Dear Ms Morris

Australia-United States Free Trade Agreement

Thank you for the opportunity to make a submission on the proposed free trade agreement between Australia and the United States.

The Australian Stock Exchange (ASX) views the proposed establishment of a Financial Services Committee (FSC), under the auspices of the free trade agreement, as a potentially important development in resolving a longstanding regulatory issue with the US Securities and Exchange Commission (SEC). Resolution of this matter offers the prospect of further enhancing the depth and liquidity of Australian capital markets through facilitating direct US investor access to our market. It would also provide a framework for Australian exchanges wishing to offer services to US investors similar to the treatment already afforded to US exchanges wishing to operate in Australia by the Australian Securities and Investments Commission.

While acknowledging the benefits of having a formal process to conduct a dialogue with the US on this issue, we do not underestimate the difficult task in getting the SEC to give ground and provide a simple and effective regulatory solution. However, we pledge our full support to the process and stand willing to provide any assistance we can to Australia's representatives on the FSC.

Background on trade policy

ASX recognises that the gains from increased trade and investment flows between countries, through the reduction in barriers, are potentially significant, particularly for small, open economies such as Australia.

Australia's economic performance in recent years has been outstanding, particularly in an environment of general global weakness. The foundations of this performance were the major economic reforms of the 1980s and 1990s. Among the most important of these

reforms were the deregulation of the financial system, the floating of the Australian dollar, the removal of exchange controls, and the lowering of trade barriers.

As such, we support moves to reduce further barriers which impede our integration with the rest of the world. While multilateral agreements offer the greatest potential benefits, we acknowledge that the difficulties with, and delays in, negotiating such agreements should not mean that Australia does not pursue bilateral agreements where they are in our national interest and are consistent with our broader trade objectives. We would hope that reducing trade barriers through bilateral agreements may also provide some forward impetus to multilateral negotiations.

As one of Australia's major trading and investment partners, the United States is clearly an attractive candidate for an agreement that improves our bilateral links. Combined with other agreements in our region (Singapore and Thailand) and other moves to develop closer economic relations (China and Japan) these bilateral agreements offer the scope to promote Australia's economic interests. However, a successful outcome in the Doha Round of World Trade Organisation negotiations would clearly be the most significant outcome for Australia and the global economic system more generally.

This submission focuses on the proposals contained in the free trade agreement designed to improve the integration of the Australian and US capital markets. In particular, ASX supports the establishment of the proposed Financial Services Committee.

Rationale for facilitating capital flows

From ASX's perspective, proposals that facilitate capital flows between Australia and the US offer scope for gains to investors, borrowers and financial intermediaries on both sides of the Pacific. They can also help to enhance the depth and liquidity of capital markets in Australia, lowering the cost of capital, and facilitating stronger economic growth. It may also encourage companies to remain based in Australia by possibly making it easier for Australian companies to tap US capital markets to finance their expansion plans.

Australian capital markets are already strong and have an international reputation for high levels of integrity. Australia is the eighth largest capital market, as measured by the Morgan Stanley Capital International index (MSCI), making up 2.22 per cent of the global index and around 40 per cent of the Asia (excluding Japan) index.

The MSCI indices provide global benchmarks against which fund managers measure their performance. Morgan Stanley estimates that around \$US3 trillion is currently benchmarked to these indices on a global basis. A country's weighting in an MSCI index can affect fund manager asset allocation decisions between alternative investment destinations.

Given our relatively small size on a global scale, one challenge that Australia will face into the future will be how to maintain our global relevance should other markets in our region grow at a faster rate than ours. If our relative market size declines in the future and investors turn to other countries, trading activity and overall market liquidity may fall. This can translate into a less dynamic local capital market and a higher cost of capital for local companies.

There are a number of ways in which we can seek to meet these challenges.

Maintaining our high standards of market integrity and efficiency will obviously continue to underpin our attraction as an investment destination.

We will also need to explore ways of growing our markets through increasing the range and scope of the listed products available to investors. The funds raised can be used to finance worthwhile investment projects that can add to Australia's productive capacity, underpinning future economic growth and higher living standards.

Impediments to capital flows

Another way is to increase access to our markets, particularly by foreign participants and investors, as a means of facilitating capital flows to Australia. While advances in technology have broken down many barriers to cross border trading, regulation in some countries has not always kept pace with these trends. An issue, of relevance in the FTA context, that ASX has been pursuing for some time have been restrictions placed on the ability of US investors to directly access Australian equity markets.

As the situation currently stands, US investors seeking to trade in securities of Australian companies generally have to pay commissions to multiple intermediaries to invest in Australian companies listed on ASX. For example, a US investor would contact a local US broker-dealer participant to find out information on an Australian security and then to place an order. This order would, in turn, be forwarded to an Australian broker-dealer participant for execution on our market.

Reducing US regulatory restrictions, and allowing ASX to place trading screens in the US, would benefit US investors by increasing the investment choices available to them through lowering transaction costs associated with purchasing Australian equities. In turn, it would provide benefits to Australian companies through potentially expanding the pool of capital they are able to draw upon.

ASX's original intention in seeking direct trading linkages with a US counterpart, through the ASX World Link service, was to make it easier for foreign investors to trade in Australian listed companies and for Australian investors to trade in foreign listed companies. However, because of the regulatory impediments in the US, this objective has not been realised. The ASX World Link service currently provides only a one-way link whereby Australian investors are able to transact in a range of securities listed on the New York Stock Exchange and Nasdaq market as seamlessly as they are able to invest in local Australian companies, with settlement in Australian dollars. As yet, because of regulatory impediments, there is no reciprocal link to the US¹ to allow US residents to trade as seamlessly in Australian listed stocks.

ASX has also sought to facilitate direct access by foreigners to our markets by changing ASX's business rules to make it possible for foreign-based institutions to become trading participants in ASX markets without the need to establish a local presence. To do so they would need to have a relationship with a locally-based clearing participant. However, current US regulatory arrangements are such that allowing a US based institution to become a trading participant would impose a potentially significant regulatory burden on ASX.

Nature of regulatory impediments

The development of a link allowing US investors easier access to Australian-based securities has been hampered by the US regulators having not directly addressed the regulatory status of entities that provide US persons with the ability to trade directly on foreign markets from the United States.

¹ ASX World Link does operate a two way trading link with Singapore.

Foreign exchanges have been discouraged from offering US persons the ability to become members of their markets without assurances from the Securities and Exchange Commission (SEC) that they would not be required to register as national securities exchanges.

Registration as a national securities exchange in the US would place significant burdens on a foreign exchange. For example, they may be required to adapt their exchange rules and operating procedures to comply with technical requirements of the SEC with little marginal increase in investor protection over that applied by their home regulators. While the SEC has the power to grant exemptive relief from some of the requirements, the costs of submitting to a second regulatory regime, with different information disclosure standards, recordkeeping and other regulatory requirements would continue to discourage foreign exchanges with only limited US based operations from offering their listed securities to US investors.

Foreign markets can also have different practices to ensure market integrity than those applying within the US. These can relate to a range of matters including: requirements for the timely reporting of trades, rules relating to insider trading and market manipulation, and the requirement for reporting of specific company information. The standards may well differ from those applying in the US and registration as a national exchange in the US could require the foreign market to change its existing practices and/or expose themselves to duplicate regulation.

In May 1997, the SEC published a concept release on alternative trading systems which canvassed a range of options for direct access by US investors to securities quoted by foreign markets. Despite receiving submissions on this issue, no further announcement has been made to clarify the SEC's position, other than to confirm they are still examining the matter.

ASX would support regulators working together to develop a framework that facilitates cross-border trade in securities while maintaining appropriate investor protections. ASX has made a number of representations to the SEC, through correspondence and meetings, on the issue of clarifying their position on direct access. We have also joined with other exchanges in Europe and Canada to try and progress this issue with the US. To date these discussions have not yielded any tangible outcomes.

Approaches in Australia and US derivatives markets

In Australia, ASIC has been much more progressive and flexible to these cross-border issues than many other regulators – both through their approval of the ASX World Link arrangement and in their developing a general framework for access by approved foreign exchanges to Australia.

ASIC has already been active in developing proposals to provide a consistent framework for allowing foreign markets to directly access Australian investors. The broad approach favoured by ASIC is one that is based around the foreign market generally being an authorised market operator in its home jurisdiction, operating a fair, orderly and transparent market, having adequate arrangements for supervising the market, having sufficient resources and providing ASIC with an annual report for all its activities including its Australian activities.

We believe that generally such a model strikes a balance between providing Australian investors with greater investment choice while ensuring an appropriate degree of investor protection. We have already seen this framework being used by foreign derivative

exchanges, such as the Chicago Mercantile Exchange, to allow them to operate in Australia.

The other major market regulator in the US, the Commodity Futures Trading Commission (responsible for the regulation of futures markets) is already more comfortable with allowing direct access to foreign derivative exchanges, and has a regulatory policy and rules in place to give exemptions or “no action” relief based on exchanges having comparable regulatory and self-regulatory requirements in their home jurisdiction.

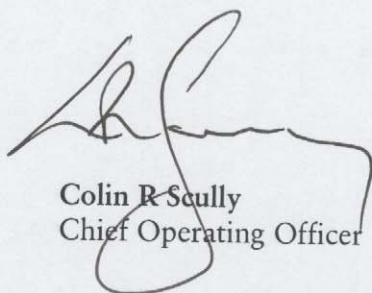
As noted above, ASX supports the free trade agreement as a means of addressing this impediment and the proposal to establish a Financial Services Committee (FSC) to consider issues, including ways to further integrate our financial services sectors.²

The FSC can provide an ideal forum to progress the issue of direct access, although we recognise that the ultimate success of the FSC’s work will require the US securities regulator, the SEC, to adopt a different approach to that which it has adopted to date.

In summary, we would hope that the proposal in the free trade agreement to establish a Financial Services Committee to discuss greater integration between US and Australia markets can achieve positive outcomes that provide real benefits to Australian companies, investors and capital markets. In the first instance, any success in crafting a regulatory regime that provides direct access for US investors to Australian capital markets, without applying an unnecessary additional layer of regulation through greater recognition by US regulators of the high standards of integrity and regulatory oversight of Australian markets, would be welcome.

If you have any questions on the issues raised in this submission you should contact Mr Gary Hobourn (tel: 02 9227 0930; email: gary.hobourn@asx.com.au).

Yours sincerely



Colin R Scully
Chief Operating Officer

² The side letter on financial services specifically noted that the parties agreed that the FSC would discuss among other things “cross-border access for foreign securities markets.”