Australian Shareholders' Association

Australian Shareholders' Association Limited
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CHESS moves deliver ASX their annus horribilis

Company/ASX Code	ASX Limited/ASX
AGM time and date	10.00am (Sydney time) 19 October 2023
Location	ASX Auditorium, Lower Ground Floor, Exchange Square, 18 Bridge Street Sydney, and online https://meetings.linkgroup.com/ASX23
Registry	Link Market Services
Type of meeting	Hybrid
Monitor	Peter Gregory assisted by Sue Howes
Pre-AGM Meeting	Yes with Chair Damian Roche; REM Chair, Melinda Conrad; General Manager Reward, Will Milthorpe; and General Manager IR and Sustainability, Simon Starr.

Monitor Shareholding: The individuals (or their associates) involved in the preparation of this voting intention have no shareholding in this company.

1. How we intend to vote

No.	Resolution description	
3	Adoption of Remuneration Report	Against
4	Grant of Performance Rights to the Managing Director and CEO Helen Lofthouse	For
5a	Re-election of Damian Roche as a Director	For (conditional)
5b	Election of Vicki Carter as a Director	For
5c	Election of Luke Randell as a Director	Undecided
6	Election of Philip Galvin as a Director	For
7	Spill Resolution - Conditional Resolution	Against

2. Summary of Issues and Voting Intentions for AGM

- While improvements have been made in the Long-Term Incentive (LTI) there remain significant variations from ASA guidelines with their Short-Term Incentive (STI). The remuneration plan is still not seen to be consistent with shareholders' best interest.
- The board oversight of CHESS replacement project and the events of FY23.
- Changing competitive landscape and the implementation of the Transformation process and the new 5-year strategy

See ASA Voting guidelines and Investment Glossary for definitions.

3. Matters Considered

Accounts and reports

The past year has been, for ASX, their annus horribilis.

The CHESS replacement project, which for some time, has suffered technical concerns and delays, was paused by ASX on 17 November 2022. This decision was made following a report, commissioned by ASX and independently completed by Accenture, which identified significant challenges with the solution design and its abilities to meet ASX's requirements. With this solution uncertainty ASX also made the decision to derecognise the CHESS replacement capitalised software resulting in a FY23 charge of $253 million.

The ASX's CHESS delay announcement also announced the immediate appointment of Tim Whiteley, a highly experienced technology transformation executive, as Project Director for the next phase of the CHESS replacement project.

This pause to the CHESS replacement project has had significant implications for ASX.

- As is appropriate the regulators, ASIC and RBA, have heightened their scrutiny of ASX requiring additional oversight; have requested extensive reporting on the CHESS replacement project; and sought assurance of the robustness of the current CHESS processes.
- ASIC has also required an increased level of engagement with stakeholders to ensure that future CHESS will fully meet the needs of the industry as well as ASX.
- In March 2023, ASIC has commenced an investigation into suspected contraventions of the ASIC Act and Corporations Act in relation to the CHESS replacement project.
- Those industry stakeholders who have invested a considerable amount of time and money working with ASX in testing and building their systems to integrate with the future CHESS are very disappointed and frustrated.
- And shareholders have experienced a FY23 statutory profit that is down 37.6% vs pcp largely due to the derecognition and other costs associated with the pause, together with reduced dividend (down 3.4%) from a decrease in underlying profit. For FY24 ASX has reduced the dividend payout ratio of 90% to between 80% and 90% of underlying NPAT.

Looking forward, the Board acknowledges the need to rebuild trust with all stakeholders and has stated commitment to this.

Financial performance

(As at FYE)	2023	2022	2021	2020	2019
Revenue ($m)	1,404.3	1,082.8	951.5	938.4	863.8
NPAT ($m)	317.3	508.5	480.9	498.6	492.0
UPAT ($m)	540.2	508.5	480.9	513.8	492.0
Share price ($)	63.00	81.71	77.71	85.38	82.370
Dividend (cents)	228.3	236.4	223.6	238.9	357.800
Simple TSR (%)	(20.10)	8.17	(6.23)	6.55	33.50
EPS (cents)	163.9	262.7	248.4	257.6	254.1
CEO total remuneration, actual ($m)*	2.31	4.54	4.31	3.63	2.87

* Ms Lofthouse commenced the CEO role August 2022.

Simple TSR is calculated by dividing (change in share price plus dividend paid during the year, excluding franking, by the share price at the start of the year.

While revenue has shown a 29.7% increase for the year, this is largely due to interest income. Revenue excluding interest was negative 2.7% and is a better reflection of the ongoing business.

Net profit after tax (NPAT) was down 37.6% significantly impacted from CHESS related costs of $285m. Underlying profit after tax (UPAT,) reflecting the core business, was negative 3.4%

ASX's diversified business model saw weakness in Markets, and Securities and Payments offset by growth in Listings, and Technology and Data against a background of increasing inflation and some weakness in capital market activity.

Expense growth was 12.3%, driven by staff, equipment and administration costs to support enterprise-wide initiatives, as well as CHESS replacement solution design and CHESS related review and associated costs.

Governance and culture

At the ASX Investor Day in June the CEO announced their 5-year strategy based on a new Purpose and Vision, built on these 4 Pillars:

- One ASX,
- Great Fundamentals,
- Customer Driven, and
- Digital by Design.

See page 5 of the Annual Report for more information.

The first implementation horizon of the 5-year strategy is delivering on regulatory commitments and technology modernisation under the Great Fundamental pillar.

This strategy reset, supported by a new organisation structure and leadership appointments, investments in development of people, rapid responses to overcome the regulatory and trust issues caused by the CHESS replacement project pause, and a greater commitment to accountability should give the ASX a clearer sense of purpose and stronger culture going forward.

Shareholders will look forward to seeing long term sustainable value from ASX.

Key events

Starting with the ASX initiated Accenture review of the CHESS replacement project and subsequent pause, ASX has been required by the regulators to undertake a number of reviews which have now been published. Consequently, ASX is putting in place critical stakeholder engagement mechanisms of an Industry Advisory Group, led Alan Cameron as Independent Chair, and the establishment of the Partnership Program. The Partnership Program is an up to $70 million program that provides financial contribution to stakeholders for their ongoing participation in the CHESS replacement project.

On 6 September 2023, this Treasury media release - new legislation to promote competition in financial markets outlined the passage of legislation to support competition in clearing and settlement services. This a field where ASX enjoyed a monopoly. While the ASX Annual Report talks of ASX strengths and tailwinds that create opportunities for the company, ASX will also face increased competition. This legislation, together with the recent entry, through the acquisition of Chi-X by Cboe, changes the competitive landscape. Shareholders need to feel confidence in the 5-year strategy that ASX is responding to this changing situation. Note Cboe is a global business operating exchanges in the US, Europe, Canada, Japan and Australia, offering many services that are similar to ASX. It has a mission “to build a trusted, inclusive global market place that enables people to pursue a sustainable financial future”. Given that ASX is the 8th largest securities exchange in the world other competitors may also be attracted to this more open market place in Australia.

Key board or senior management changes

ASX has continued on a process of board renewal with 2 new directors being elected at the FY22 AGM and a further 2 standing for election at the AGM. ASX has a minimally useful board skills matrix that makes it challenging for shareholders to make decisions about electing directors.

During the year, Melinda Conrad has become the Chair of the People and Culture Committee.

Since the appointment of Helen Lofthouse as CEO in August 2022, the executive team now comprises 1 who retains his previous responsibility, 4 who have had changes in their responsibility and 6 new external hires. This is an unusual level of change in a short space of time, and given the challenges facing ASX these people will need to quickly integrate into ASX and collectively work to restore value to shareholders.

The organisation is now structured into the 4 operating businesses of Listings, Markets, Technology and Data, and Securities and Payments. Supporting these are 7 enabling functions. Each business and enabling function are led by a member of the ASX Executive all reporting to the

CEO. This organisation with clear delineation of responsibilities should lead to enhanced focus and stronger accountability.

Sustainability/ESG

ASX are working to develop products that will support decarbonisation in the Australian economy through its electricity futures product and is working to develop carbon futures products.

ASX has set a target of reaching net zero for its scope 1 and 2 emissions in FY25. ASX is already sourcing 100% renewable electricity, and has reduced total scope 1 and 2 emissions against their FY21 baseline by 85% in FT23. ASX have implemented an e-waste strategy, and are actively implementing energy saving projects such as HVAC and lighting upgrades that will both reduce emissions and save an estimated $30,000.

ASX is committed to good governance as is commensurate with the nature and scope of its operations and claims to have appropriate processes in place. Although as discussed earlier in FY23 this has been tested by the CHESS replacement project experience.

4. Rationale for Voting Intentions

Resolution 3 - Adoption of Remuneration Report - Against

For FY24 ASX is improving its LTI remuneration by extending it from only the CEO to all of the Executive Team; by increasing the LTI proportion of total remuneration from 17% to 31% of fixed pay; and by changing from the EPS metric to underlying ROE. These changes will bring better alignment with the interests of individual shareholders.

The STI is how each executive is rewarded for their contribution to the company for the past year, and given the immediate challenges ASX faces this is critically important.

In FY23 remuneration report the board has made an appropriate STI adjustment for those involved with the CHESS replacement project.

This adjustment aside, we still have an issue with the lack of disclosure of how the STI payment for each of the executive team is arrived at and how the process operates. Discretion is normally exercised by the board and appears to be a key determinant of the final reward received for each individual. The basis for discretion is not explained to shareholders. Refer to details in the appendix. These factors are inconsistent with the stated ASX management focus on “executing with discipline” and commitment to “accountability”.

ASX STI does not meet the ASA guideline that “remuneration report should be readable, transparent and understandable for investors.” And, in the circumstance of a company embarking on a new direction, as ASX is, the STI has a critical role in aligning company leadership with that future.

The STI is the primary reason ASA has voted against the remuneration report for the last 2 years and for the reasons above ASA will again vote undirected proxies against.

Resolution 4 - Grant of Performance Rights to the Managing Director and CEO Helen Lofthouse - For

The CEO’s LTI is now the largest component of the at risk remuneration, and at maximum is now equal to fixed remuneration. This is consistent with ASA guidelines so all undirected proxies will be voted for.

Resolution 5a - Re-election of Damian Roche as a Director - For (subject to a condition)

In FY23 ASX the challenges with CHESS have increased and ASX has experienced significantly negative consequences from the implementation of its CHESS replacement project. As a result, the board has invoked malus provisions to withhold unvested LTI grants of the previous deputy CEO and CEO. For FY23 current company executives who had responsibility for the CHESS replacement project have had the board exercise its discretion to make material reductions to their STI grant.

The Annual Report states “The ASX Board believes that good governance underpins strong business performance and is essential to retaining the trust and goodwill of ASX’s stakeholders, including shareholders, employees, regulators, customers, market participants, and the broader market.” The board shares the responsibility with the past and present executives referred to and Mr Roche who, from the commencement of the CHESS replacement project, as firstly a director and since April 2021, Chair of ASX, has not met the board’s own expectation as just described.

This on its own is sufficient reason for ASA to vote against his re-election. However, we recognise that there is not a satisfactory chair succession plan in place and that an immediate removal of the chair would be disruptive for the company, and we expect further damage the company’s relationship with the regulators. At the AGM we will ask Mr Roche for his commitment to have a new Chair in place within 12 months. Only if this undertaking is forthcoming will we vote for this resolution.

Resolution 5b - Election of Vicki Carter as a Director - For

From the information provided in the director biographies provided it appears that Ms Carter has the additive skills and experiences in organisational transformation, customer service, product design and delivery. Through her experience with Telstra she has worked in a highly competitive and technically based environment in a leadership role of a highly disciplined transformation process. With this background she is well equipped to assist with the implementation of the ASX 5-year strategy.

Resolution 5c - Election of Luke Randell as a Director - Undecided

Mr Randell’s skills and experiences, from the information provided, do not appear to be markedly different from other current members of the board. To determine whether to vote for or against this resolution at the AGM, we will ask him to describe how he adds value to the ASX board and the achievement of the stated future Purpose and Vision.

Resolution 6 - Election of Philip Galvin as a Director - For

Mr Galvin, as a shareholder of ASX, has been at recent ASX AGMs and has asked salient and challenging questions of the board. He was Executive General Manager Business Operations (KMP) at Sydney Futures Exchange when it amalgamated with ASX, and then Group Executive Integration at ASX. At SFE, the Chief Information Officer, General Manager Technology, General Manager Business Operations reported to him. He appears to have a thorough, but perhaps dated understanding of the business. We believe that if elected as a director he would actively, respectfully and constructively challenge the status quo. While he lacks the qualifications and experience that would usually be expected of a director of an ASX listed company, we have decided that he would positively contribute to the board discussions, and most importantly would have the perspective of individual shareholders.

Resolution 7 - Spill Resolution - Conditional Resolution - Against

A spill resolution is very disruptive to an organisation and in particular that applies to ASX given the challenges with CHESS and the expectations of regulators. It would not benefit from any interruption in the functioning of the company's leadership. A spill would not be in the best interest of shareholders.

Appendix 1
Remuneration framework detail

Following the strike on remuneration at the FY22 AGM, ASX have responded in two ways.

Firstly, the board exercised discretion to reduce STVR (STI) payments by up to 50% of target to those continuing executives who had responsibility for the CHESS replacement project.

And secondly, the remuneration committee has made changes to the remuneration plan from FY24 onwards. These are:

- The overall structure of remuneration for the CEO has been adjusted to increase the proportion of the LTVR (LTI) from 17% to 31% with the STVR reducing from 50% of total remuneration to 38%. These tables show FY23 and FY24 plans.

Current remuneration framework detail

Group CEO Remuneration Framework for FY23	Target $'m	% of Total	Max. Opportunity $'m	% of Total
Fixed Remuneration	2.0	46%	2 .0	33%
STI - Cash	0.8	18%	1.2	20%
STI - Equity deferred over 2 and 4 years	1.2	27%	1.8	30%
LTI** Tested after 4 years	0.37	8%	1.0	17%
Total	4.37	100%	6.0	100%

** EPS growth and Relative TSR over 4 years vs mean of ASX100 (excl property trusts).

Future remuneration framework detail

Group CEO Remuneration Framework for FY24	Target $'m	% of Total	Max. Opportunity $'m	% of Total
Fixed Remuneration	2.0	50%	2	31%
STI - Cash	0.81	20%	1.22	19%
STI - Equity deferred for 1 and 2 years	0.81	20%	1.22	19%
LTI** Tested after 4 years	0.37	9%	2	31%
Total	3.99	100%	6.44	100%

** Underlying ROE and Relative TSR over 4 years vs ASX100 index

- Previously, only the CEO had participated in the LTVR; now all of the Executives participate.
- ASX is continuing with relative TSR as a LTVR measure, but is replacing the EPS measure with Underlying ROE. ROE payment will start at 13% with maximum at 14.5%. We have suggested that the maximum be increased to provide greater stretch.

While we support these changes with the LVTR, we remain concerned about the STVR employed by ASX. This is overly complex, lacking in transparency and clear accountability. There is an over reliance on unexplained discretion in determining the outcome. From the information provided in the Annual Report we have summarised the ASX STVR process as follows:

There are two similar processes that determine the STVR result for ASX Executives. The following describes this for all Executives excluding the CEO. The CEOs STVR process is the same except that she participates in her individual funding pool.

(a.) is the ASA commentary.

1. Determine the **potential size of the Reward pool**. Each Executive has a maximum value of STVR agreed to as a % age of their fixed remuneration. The reward for at target outcomes is 2/3 of this maximum amount. The Reward pool is the sum of the target reward for the Executives in the plan.
2. The value of the at target Reward pool is then adjusted up or down, based on the outcome of the Group Scorecard shown on page 52 of the Annual Report. This Scorecard lists group relevant performance targets, describes the outcome of each and indication of met, not met or exceeded target.
    a. In the Scorecard there is no weighting applied to each of the categories. In most cases the targets are qualitative or not well defined, so it is not clear why scores have been given. There is no gateway for either financial outcomes or risk. The results are shown graphically without any specific level of achievement stated.

3. The board assesses **the outcome of the Scorecard** and assigns a total % achievement number. This % age (which may range from 0% to 150%) is applied to the target Reward pool to set the total maximum STVR opportunity for the Executive group for the year. In the case of FY23 the Board after reviewing the Scorecard outcomes made this statement "The Board considers the Group Reward pool of 90% appropriately reflects the underlying performance of the Group in FY23."
    a. No explanation was provided as to how this was determined. Without further information, this appears to be an informed judgement call by the board.
4. For FY23 the **Board exercised additional discretion** to adjust the Group Reward pool further to take into account the impact of the CHESS situation on ASX reputation and the reduction in statutory profit from the derecognition of CHESS capitalised software costs. This action further reduced the Group Reward pool by 40% resulting in a final Group Reward Pool that was 50% of the at target Reward pool.
5. At this stage the **Group Reward Pool is set as the maximum amount** available for allocation to individual Executives. The total of Group Reward Pool allocated to Executives may be less that this maximum.
6. Each Executive has an **individual performance rating based** on individual goals linked to ASX strategy, behaviour and risk management, and management of their accountabilities. This performance rating of each individual determines what percentage of that individuals STVR are received. This ranges from 0% to 150%.
    a. There is no disclosure about how this process operates, the weighting gives to each metric or the basis for outcomes to be measured.

In parallel with using this process the board uses an extensive set of inputs in arriving at the final amount allocated to each Executive.

However overall, our assessment is that this is an overly complex process; involves subjectivity and discretion by the Board; appears to lack clear definition of what is to be achieved with insufficient quantitative metrics and specific qualitative measures.

It does not meet ASX's stated management focus on "executing with discipline" and commitment to "accountability". Nor does it meet the ASA guideline that "remuneration report should be readable, transparent and understandable for investors." And it would appear to be difficult for Executives to understand how their final remuneration is arrived at, thus impacting on the remuneration plan being a means of setting their direction and providing motivation.