



Office of the General Counsel
ASX Ltd
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By email: regulatorypolicy@asx.com.au

Attention: Ms Diane Lewis
Senior Manager, Regulatory and Public Policy

Dear Ms Lewis

Replacement of CHES for Equity Post-Trade Services: Business Requirements

The Australian Financial Markets Association (AFMA) welcomes the opportunity to submit a response to the consultation paper on ASX's Replacement of CHES for Equity Post-Trade Services: Business Requirements. Our comments are based on member feedback and address the application of a new CHES infrastructure and how it may best serve the market and its participants based on an overall assessment of requirements. We do not address the specific functionality requirements of a new system.

1. General assessment of member reaction

The replacement of CHES is a vital consideration for market participants, as it represents a core piece of financial market infrastructure, and one that may shape the clearing and settlement landscape for the decades to come. Based on consultation with our members, feedback indicates that there are diverse views on the requirements and need for a new CHES system. We acknowledge that the paper is a first consultation by the ASX and further information will be forthcoming at the appropriate time. As such, members have viewed this on a macro level and cannot pass comment at a more granular level until further details are communicated to the market. This is particularly important in trying to assess the costs and benefits attributable to members and to market efficiency. The functionality aspects of the proposal are difficult to articulate in any detail, and as mentioned, won't be assessed in this submission. Varying degrees of thought exist across our membership which, given its broad nature, is not unexpected. The general view is that current functionality must be maintained at a minimum and that in the first instance modest, well planned change within a well-developed long term development strategy is the least risky approach to success.

Overall, it is believed that any move to a replacement system should seek to reduce the current risk profile for all stakeholders. If risk decreases are achieved, there should be associated cost reductions as a direct result of this change. These cost reductions may span across the spectrum of charges currently borne by members and the CCP. This may include but not be limited to capital savings and general fee reductions.

2. Reform in conformance with Government policy

One of the primary statutory obligations of a clearing and settlement (CS) facility licensee is to do all things necessary to ensure its clearing and settlement services are provided in a fair and effective way, to the extent it is reasonably practicable to do so. It is an automatic assumption of AFMA that any replacement system will conform to Government regulatory requirements and policy relating to systemic stability of financial market infrastructure and competition in cash equity clearing¹.

Assessment of the replacement would be done against the backdrop of the implementation of the CPSS-IOSCO Principles for financial market infrastructures in Australia². It follows then that the overriding principles of stability and efficiency must be maintained within any framework of change. AFMA supports these guiding principles set out in the paper which need to form the basis for evaluating any changes to the clearing and settlement system. An upgrade that also looks to decrease the systemic risk to the market would be viewed as an important positive factor by members. This is not limited to financial risk but should address operational risk aspects that each participant currently manages.

It is noted that in addition to access to the CS system and the possibility of competition from other CCPs, a replacement system with enhanced capability may also open up debate on competition in relation to corporate registry services. Most communications between issuers and shareholders in relation to corporate actions, such as the notification of entitlements or obligations and the lodgement of applications, elections of any monies payable etc occur directly between the issuer's appointed share registrar and the holder without the involvement of CHES. AFMA does not have a view on this possible consequential development but it should be flagged at this point as an area of competition policy interest which could arise in the future.

3. ISO 20022

ISO 20022 is the new messaging standard for interoperability for the financial services industry. The Australian markets should ideally move to a global standard of messaging, particularly if the costs for maintenance are reduced from the current system. This is in line with the move by the Australian Payments Clearing Association (APCA) to use ISO 20022 in the development of the New Payments Platform (NPP) which is due for operational release in the second half of 2017. Consistency across settlement and payments messaging would be a preferred state.

Having stated the above, there appear to be divergent views about the need to implement ISO 20022. Internationally owned brokers tend to support the new messaging protocol, however some concerns have been raised by locally owned brokers who suggest that this will purely be a business cost with little efficiency gain. This aspect will need to be managed accordingly, notwithstanding the offer of translation services to those who don't wish to upgrade.

¹ Policy Statement by the Council of Financial Regulators, *Regulatory Expectations for Conduct in Operating Cash Equity Clearing and Settlement Services in Australia*, October 2016

² Reserve Bank of Australia, *Implementing the CPSS-IOSCO Principles for financial market infrastructures in Australia*, February 2013

4. Change to settlement period choices

The option to potentially move to a choice of settlement period raises a number of questions which require more detail. While as a general rule a shorter settlement time may be of interest to members, more definitive details are needed before this can be fully explored. The belief is that it should be incumbent on the ASX to determine the default settlement period and not allow market participants to unilaterally determine these times. A number of different schedules would cause confusion and potentially an increase in failed trades across the market.

Similarly, there are multiple questions around an immediate move to T+1 as an option. More information is required on how this could work in practice. Issues may evolve around the ability of custodians and registries to deliver stock on time in a shortened settlement cycle, particularly if they are located offshore.

There is no clarity on how the cost component of changing the settlement period could facilitate cost reductions to the market. Considerations relating to reduction in the capital required to be utilised by participants and how the default fund may function under an improved risk profile have been highlighted as key determinants on this prospect. These will need to be discussed further before a definitive decision could be made on timing.

5. Dematerialisation and settlement finality within current statutory framework

The functionality of the clearing house electronic sub-register system rather than the ASX Settlement infrastructure as a whole is of core importance. There are various functionalities incorporated within ASX Settlement, one of which is CHES but also the Deliver v Payment arrangements. AFMA believes that there are long recognised benefits in CHES with regards to dematerialisation and settlement finality which are supported by the current statutory framework and should be preserved.

The legal finality given by this system provides major value to the Australian market in terms of transaction efficiency, risk management and legal certainty. AFMA would not want to see the value of the legal framework lost.

6. Conclusion

AFMA recognises that this consultation paper is the first of a series of engagements with stakeholders around the replacement of CHES. It is clear that the market has raised a number of questions that will require a much greater level of detail before any real decisions can be made. A key driver of any upgrade will be to ensure that the reliability, security and access issues of any implementation is maintained and that the relevant cost structure and savings could be achieved for stakeholders. AFMA will continue to engage with the ASX and its members to ensure that all aspects of change are considered and in the best interest of the market as a whole.

If you have any queries with regard to these comments please contact myself on 02 9776 7993 or at dkennedy@afma.com.au.

Yours sincerely

David Kennedy
Head of Markets