

28 October 2016

Regulatory & Public Policy
Australian Securities Exchange
20 Bridge Street
SYDNEY NSW 2000

By email: regulatorypolicy@asx.com.au

Consultation Paper: ASX's replacement of CHES for Equity-Post Trade Services

Stockbrokers Association Members (Members) welcome the commencement of the CHES Replacement initiative and the opportunity to provide input into the requirements phase of the investment strategy for the replacement infrastructure.

This response expresses the considered and representative views of global broker dealers, global custodians, third party clearers, domestic retail full service and non-advice firms. Members represent a strong core of Clearing and Settlement Participants (CS Participants) who are the direct users of CHES. Members thank ASX for its participation in the workshops with Members to allow for more detailed discussions on the requirements and changes expected for CHES Replacement.

The Members note that the Guiding Principles that ASX proposed for CHES Replacement were focused on the benefits for Issuers and Investors, but failed to address the role of CS Participants. ASX should seek to affirm in these principles that CHES Replacement should operate with the highest priority for the benefit of CS Participants who are ASX's clients and the primary users of CHES.

The Council of Financial Regulators' October 2016 Policy Statement on Regulatory Expectations for Conduct in Operating Cash Equity Clearing and Settlement Services in Australia (COFR Regulatory Expectations) provides clarity both for ASX and Members in the conduct for the Investment in Clearing and Settlement Infrastructure (CS Infrastructure).

In line with COFR Regulatory Expectations, Members request that ASX demonstrate how CHES Replacement will both meet efficient costs and fair pricing expectations. Members strongly recommend that ASX recognise in their guiding principles for the replacement of CHES a minimum target of a **20% reduction in operating costs** for CHES Replacement Day 1 for all parties: ASX Clear, ASX Settlement and CS Participants.

In addition, ASX's approach with CHES Replacement pursues a like-for-like CHES Replacement strategy with limited new functionality and services. Members believe that it fails to deliver initial net benefits to CS Participants.

Members do not support optional early settlement or multiple settlement batches. These are potentially complex and high cost and high risk developments. Members strongly recommend ASX reconsider the enhancements to be included in CHES Replacement and recognise that the highest priority requirements for CS Participants are those that provide reduced manual processing, reduced risk and, therefore, reduced cost to the broadest base of CS Participants. Areas where this could be achieved include:

- **Corporate Actions Processing** – there is a lack of standardisation and automation of corporate action processing, including the capture of investor elections and proxy voting.
- **Asset Registration Efficiencies** – improvements to the standards for maintenance of investor information and automation of transfers/ conversions between Issuer and CHES sub-registers.

CS Participants acknowledge that these are industry-level solutions and strongly encourage ASX to work collaboratively with Registries to improve standards and automation of processing, while also maintaining investor choice in asset registration and competitive market structures.

ASX had indicated it will lock-down requirements for its vendor in November 2016. Given the brevity of the consultation paper and the limited time to respond, many Members feel they are unable to give adequate consideration to the matters raised. Members subsequently feel that they have not been given the opportunity to provide a strong voice to the investment strategy for the future Clearing and Settlement Infrastructure (CS Infrastructure) as Members believe is an expectation of the Regulators. Members welcome ASX's proposal to continue engagement on the potential enhancements before a final determination is made for Day 1 replacement.

In line with COFR Regulatory Expectations, as well as continuing documented formal engagement on the input and design of CHES Replacement, Members seek confirmation that ASX will:

- Provide **independent validation** on the decision to support DLT for CHES Replacement to the **Business Committee** for **endorsement**; and
- Provide **transparency** on the capital investment costs for **core Clearing and Settlement services** and **demonstrate clear prioritisation** for the delivery of these services to the Business Committee in priority ahead of non-critical services.

Conclusion

Members intentions are to ensure their strong voice is accounted for in the context of system design for ASX's monopoly cash equity clearing and settlement services and so welcome ASX's offer for continued engagement during the current decision making period. Members also welcome COFR Regulatory Expectations for direct accountability to CS Participants who are critical and majority users of CHES.

By reconsidering Member priority enhancements in Day 1 replacement, and with greater clarity on committed timelines, Members are better placed to confidently determine whether CHES Replacement can achieve a net benefit for users. ASX should bear in mind that commercial organisations typically work with investment pay-offs of within three years.

Members appreciate the opportunity to provide comments in respect of this Consultation Paper and welcome further and ongoing engagement with ASX. Should you require any additional information or wish to discuss further any of the matters raised in this Submission, please contact me or our Policy Advisor, Danielle Henderson. (dhenderson@stockbrokers.org.au)

Yours sincerely,



Andrew Green
CHIEF EXECUTIVE

Scope of CHES Replacement

Potential Service Enhancements

Response to Consultation Questions

Q1. Are there any other key business functions provided by CHES that have not been identified in this paper that should be supported by the system that replaces CHES? Explain the importance and value of any such business functions to you.

Members strongly recommend a reconsideration of the expected functional enhancements to be included in CHES Replacement. The highest priority requirements for CS Participants are those that provide reduced manual processing, reduced risk and, therefore, reduced cost to the broadest base of CS Participants. There was universal support from Members that CHES Replacement include corporate action enhancements and asset registration efficiencies.

Corporate Action Enhancements

ASX Settlements maintains a CHES sub-register of owners and facilitates an asset registration service. Further, CHES supports Issuer Administration services for Issuers on all approved listing markets (ie ASX, SSX, NSX and Chi-X). The consultation paper for CHES Replacement has not presented any improvements in access and processing of corporate entitlements resulting from mandatory corporate actions, nor in the processing of voluntary elections from Investors, including proxy voting.

Processing for Corporate Actions

Market Participants and members of ASX's Business Committee have raised corporate action *straight through processing* (STP) as necessary innovations in settlement services on a number of occasions. Matters discussed in the Business Committee include communication, notification and responses. On 27 May 2015, the Business Committee endorsed the recommendation for implementation of "Corporate Actions STP Phase 2" to commence in July 2016, prior to the CHES Replacement initiative. Phase 2 covered the inclusion of an additional five corporate action messages in the STP initiative and was consistent with the adoption of ISO 20022 standards. In the same Business Committee meeting, a further series of enhancements for Phase 3, including the processing of responses for voluntary elections from investors (the feedback loop) was recommended by the Business Committee to be incorporated as part of the CHES Replacement initiative.

Members note, with concern, the exclusion of corporate action changes in CHES

Replacement that have previously been recommended under input and governance arrangements established under the Code of Practice and that are also consistent with COFR Regulatory Expectations.

When addressing corporate action processing in CHES Replacement considerations, Members also encourage ASX to review current deficiencies in complex corporate handling (including schemes of arrangements that are currently not processed in CHES) and the handling of franking credits.

In particular, opportunities exist for the reduction of costs and inefficiencies associated with non-straight through processes, paper-based communications and non-standard information. Importantly, the current corporate action handling is error-prone, causing potential losses for CS participants. The inclusion of corporate action enhancements in CHES Replacement would deliver realisable benefits to CS Participants.

Therefore, Members strongly recommend that ASX consider including corporate action enhancements in CHES Replacement for Day 1 – in place of and in priority over – the following:

- The majority of “Potential Service Enhancements” proposed by ASX and as referenced in Question 3;
- The potential “future phases of development and new services” identified in Q15; and
- By de-scoping functions and services that are not mandatory or core to clearing and settlement service (eg mFunds).

Should corporate action efficiencies be deferred to a future release, Members request communication of a committed timeline and confirmation of delivery in the immediate release subsequent to Day 1 replacement. Members also request an outline of accountability arrangements to ensure delivery commitments are met.

Members recognise the need for, and encourage, ASX to actively collaborate with Industry and Registries to improve standardisation across registries and corporate actions processing.

While corporate action changes are not dependent on the adoption of Distributed Ledger Technology (DLT), Members welcome the exploration of how best to utilise the potential of the technology. Corporate actions have been identified as a strong

use case by global position papers, such as those issued by the UK Government Chief Scientific Adviser and the World Economic Forum on the potential application of DLT. Many publications also position that the full potential of DLT in Capital Markets can only be realised by broad-based industry collaboration.

Access for Corporate Actions

All Issuers on alternative listing market operators (ALMOs) – including NSX, SSX and Chi-X – utilise corporate action processing in the CHESSE sub-register under the Trade Acceptance Service and Settlement Facilitation Services. The consultation paper has not addressed clearly the access arrangements for ALMOs and the provision of equivalent services in the replacement CS Infrastructure. Their requirements should be incorporated into the future developments for corporate action enhancements.

Asset Registration Efficiencies

The consultation paper has not addressed opportunities for addressing the market inefficiencies in asset registration processes, nor changes in the market structure for asset sub-registers (ASX Settlement's CHESSE sub-register and the Issuer Sponsored sub-register).

Processing Efficiencies

The current process of conversion between the CHESSE and Issuer sub-registers and the transfer of holdings between sponsoring brokers within CHESSE is inefficient, paper based and costly. Importantly, the lack of consistency in – and support for – the maintenance of investor information across the industry increases transaction costs and delays. The consultation paper has not addressed improvements in transfer/conversion processes expected by the industry in Day 1 CHESSE Replacement or in future phases of development.

Universally, Members support asset registration efficiencies as the second highest priority for CHESSE Replacement, including an approach to standardise and maintain investor information.

The expected benefits to CS participants are reductions in the resource bases to support these processes, STP and a reduction in transaction costs to effect transfers. Improvements also remove friction for investors and reduce risk through timely transfers of securities holdings.

Members recognise the need for, and encourage ASX to, actively collaborate with

Industry and Registries to improve standardisation across registry processes, investor information and services to support asset registration efficiencies while also maintaining investor choice in asset registration and competitive market structures.

Future Choices on CS Infrastructure Design

The consultation paper did not address – nor seek feedback from users or CS participants on – the future vision for sub-register services, Broker Sponsored HINs or Issuer Sponsored SRNs in the design of clearing and settlement services.

The sub-register *name on register* is an atypical service compared to global markets and creates localisation requirements for existing and new entrants, limits vendor selection and increases complexity in the offering of general clearing services, which leads to higher costs for CS participants. Further, all Issuers – including those listing on Chi-X, SSX and NSX – are required to use the CHES sub-register. This can lead to higher Issuer costs than other global markets. Some members, therefore, questioned whether the future CS Infrastructure should incorporate the sub-register features.

However, for many Members, the use of CHES sub-register HIN – in conjunction with the Broker PID – has been an important tool for risk protection when dealing for end customers, particularly retail clients. The HIN provides visibility and control of client assets and, equally, the PID and Sponsorship arrangements recognise the role of the Broker in the provision of services to client. Many members advocate maintaining the Broker Sponsorship model.

Alternatively, some members envisage a more universal redesign that could fundamentally change core clearing and settlement arrangements, recognising investors should independently control their asset holdings.

The short time for consultation and the lack of detailed supporting information to guide Members, means Members are unable to give adequate consideration to the impact of the potential changes in market structure. Therefore, Members consider that no fundamental changes should be made without additional detailed consultation with Industry and would welcome further engagement.

Q2.

What are your views on ASX implementing only a limited suite of business function and service enhancements in the replacement of CHES, In order to minimise risk

and disruption to the market?

The majority of members do not support the approach from ASX to limit functional and service enhancements in CHES Replacement. Members are not adverse to change and welcome changes in CS Infrastructure that can lead to Australia remaining a low-cost and competitive capital market.

For many global firms, a like-for-like replacement further entrenches localisation requirements, limits vendor choices, localises connectivity models and leads permanently to high cost structures.

For global and local firms, a like-for-like replacement strategy with limited new functionality and services will not initially deliver net benefits to CS Participants.

Members propose that priority must be given to those CHES Replacement enhancements that deliver the greatest net benefit to a broad base of CS participants as indicated by Members in Question 1.

Members note that the scope of design for ASX's prototype for CS Infrastructure replacement using DLT will be finalised with their vendors in November 2016. Building the CS infrastructure solution from the technology base, rather than a well-documented and understood requirements base, poses a significant risk to the market.

To ensure risks and disruption are minimised, CHES Replacement should focus primarily on core clearing and settlement services that are priorities for a broad base of CS Participants.

Discretionary services that utilise CHES such as mFund developments, or complex enhancements that may have limited take-up like optional early settlement, should not be a priority and should be de-scoped from CHES Replacement in order to further minimise the risk of a large database migration.

Q3. What are your views on each of the potential business functions and service enhancements identified in the paper for implementation with the replacement of CHES?

Access to a Second CCP

Members acknowledge that in line with COFR Regulatory Expectations, CHES Replacement will be configured to address non-discriminatory access to settlement services for a second CCP. Members seek clarification on the expected model for

safe and efficient competition reflecting participant elected CCP choice.

Some members expressed concern that recognising a second CCP could potentially impact downstream systems and seek further engagement to ensure flexibility can be maintained, but changes minimised.

Should the changes identified by ASX for CHES Replacement be implemented (eg legal name on title through clearing and settlement; settlement account changes; and optional early settlement), Members request clarification that these changes do not add complexity to the netting and unwind arrangements, or for CCP interoperability, should a committed competitor in clearing emerge. Changes should not increase the barriers to competition.

Legal name on title through settlement and remove the need for a settlement accumulation HIN.

Members do not agree it is necessary to make changes to the current settlement flows and use of settlement accumulation accounts. The current arrangements, including recent changes to Trustable Obligations, meet the RBA's Financial Stability Standards for client protection.

The majority of Members recommend maintaining the use of settlement accumulation and entropot accounts. While not all Members use the settlement accumulation account, for those that do, the use of the accumulation account supports efficiencies in administration and preparedness for settlement, and does not carry a high resource cost or risk for CS participants.

In considering client protection measures, Members do not accept that the experience of BBY default is sufficient grounds for the change in asset flows. The changes would most likely make the Trustable Obligations process redundant and so further consultation on overall client protection processes for both assets and client monies would be required. There would be no benefit to the changes and likely only a cost to re-engineer internal work processes.

It was not clear from the proposed changes whether Broker PIDs and Broker HIN Sponsorship models would remain. Without the benefits of control of clients through PIDS and HINS, there is no offsetting benefit to support the ongoing administrative responsibility and cost for maintaining client information, and transfers associated with the sub-register.

With direct settlement to the HIN, it was not explained in the consultation paper how equivalent settlement arrangements would be supported for holders on the Issuer sub-register.

Settlement Period of Choice

Members gave detailed consideration to the proposal for settlement optionality for market participants and held detailed discussions with ASX to better understand the intended impacts on pre and post-trade processes in the context of multiple Approved Market Operators. The intended operation of the changes was not made clear in these talks and there were a number of unresolved concerns on unintended consequences from these changes for trading and market behaviours.

The optional early settlement is potentially a complex and high cost and high risk development that may only have limited take up and benefit. The change is expected to have high explicit costs (ie ASX fees) and implicit costs (ie participant operational costs) to support and members felt investors would not accept the passing on of these costs. The majority of Members do not support this change, although a minority did. Members therefore recommend that this change should be considered for future phases only, when more detailed consultation can allow members to give sufficient consideration to the risk, impacts and benefits.

It should be noted that the precondition for the adoption of early settlement in Europe under T2S was the facilitation of electronic cash; this is not the case for Australia. Members do not support multiple settlement batches required to support these arrangements as this would have high operational costs for CS participants.

While the changes were offered as a way of reducing clearing participants margins, Members believe the higher priority should be given to reducing the more material cost for clearing associated with the default fund.

Cost of Capital to the Clearing Facility

The size of ASX Clear's capital default fund (\$180M) is the primary driver for high clearing costs in Australia. Relative to the cost of cash market margins, Members feel a higher priority should be given to changes that support a reduction in overall clearing costs for participants and investors.

It is not clear whether adopting early settlement will allow ASX Clear to reduce

default fund capital or whether this could only be achieved through a whole of market reduction in settlement timeframes. Therefore, Members support the retention of T+2 settlement for CHES Replacement.

Members would also welcome further collaboration to work with RBA and ASX on how clearing capital, and therefore costs, can best be reduced through the CHES Replacement and a broader range of initiatives. Members seek further clarification on how it is intended that CHES Replacement systems will interface real time with clearing risk systems and how this may support more dynamic management of default fund capital.

Cost of Cash Market Margins

Early settlement could support a reduction in individual firms cash market margin requirements. Early settlement would be limited to top 200 stocks where borrow is available. If only certain positions settle early, then the correlation/portfolio effect on firm margin calculations could change, potentially leading to cash market margins increasing. Since early settlement is not guaranteed, then clients are likely to experience only temporary reductions rather than permanent reductions in margin requirements.

As optional early settlement will have a funding and stock borrow cost, automatic net savings from reductions in cash market margins are not necessarily guaranteed. Firms will need to model whether the complex changes for early settlement would be a net benefit.

T+1 Aspirations

The changes to reduced settlement from T+3 to T+2, were achieved at a client and market level after detailed consideration had been given to:

- The alignment of settlement cycles across debt and equity markets;
- Dual listed securities (namely New Zealand); and
- Ensuring settlement cycles and corporate action ex-periods were kept in line.

Members believe that settlement cycles need to be moved on a whole-of-market basis for real net benefits to be realised across the broadest base of CS participants. Members recommend T+1 remain a future aspiration, in line with global market trends and not be part of Day 1 changes.

If T+1 aspirations were achieved across the market, Members expect a potential 50% reduction in capital requirements for ASX Clear that would enable a 50% reduction in clearing fees whilst maintaining returns on capital for ASX.

Expand security encumbrance capability

Members note the proposed creation of a committed state flag for securities committed to settlement or otherwise encumbered (eg debts or margin loans). However, Members are concerned that this would create unnecessary messaging complexity and authorisation procedures to move securities in and out of encumbered states. Net benefits from using the service would be limited due to the high cost and risk of adjusting current legal and business models arrangements.

Furthermore, these changes would also only be relevant for predominantly retail Members using individual HINs; Institutional Members would not benefit from these developments.

Therefore, Members do not support this change for Day 1 CHESS Replacement. Benefits are not realisable by a broad base of CS participants and ASX should only consider delivering these changes as part of future phases after further consultation and provided net benefits can be demonstrated.

Real Time Data and service access via an API

Members welcome these proposed changes in access to CS Participants' own data and understand that these facilities may reduce CHESS report messaging costs. Data ownership has been raised as a concern and members seek further engagement on this point to ensure that no cost is added for access to own data.

Any third party authorization of access to the API and CS Participants data should be with the CS Participant's consent and adequate commercial compensation.

Q4. Would you expect the business functions and service enhancements identified in the paper to provide a net benefit to your organisation, and if so, how would you categorise the significance of the net benefit -small / medium / large?
If possible, please provide a quantification of any net benefit.

Please see the response to Question 3. Overall, Members do not currently anticipate the proposed changes will deliver a net benefit to CS Participants and many will be at a net cost. Members have proposed alternative changes for CHESS Replacement highlighted in Question 1 that will deliver the highest possible net benefits to CS

Participants.

CHES Holding Statements.

ASX indicates that security holders will receive digital holding statements and that ASX will need to collect and record holder email contact details for this purpose. These services are provided by ASX on behalf of Issuers as part of Issuer Administration Services and ASX Settlement is separately compensated for them.

To the extent that ASX requires the collection of client email addresses, CS participants will bear the cost to capture and maintain client contact information for ASX. Members request that ASX consider compensation arrangements be put in place for CS participants to cover the significant cost of provision and maintenance of data for Issuer benefits

Q5. Are there other business functions and service enhancements that are consistent with ASX's guiding principles that have not been identified and which you think should be considered as part of the replacement of CHES?

Greater Competition in General Clearing Services

It is expected that CHES Replacement and the migration towards ISO 20022 standards will mean self-clearing cannot achieve scale and cost effectiveness for other than the largest brokers with access to global vendors. Outsourcing should be expected to increase.

Many global firms limit their General Clearing services to wholesale trading participants because:

- Global clearers' systems can not handle the localised needs for the CHES sub-register that are required to support retail trading participants. This adds costs for a local vendor system and interface.
- Global firms' mandates prohibit services to retail clients and the current rules and CHES frameworks create a legal nexus to the retail client.

Local entrants in the space are limited and capital remains a necessarily high barrier to entry for General Clearers. Over-concentration in a single General Clearer and the lack of a greater competitive dynamic could potentially increase systemic risk.

ASX must review the necessary changes to ensure that new third party clearing and outsourcing arrangements are encouraged. Principal-to-Principal arrangements are common in the majority of global markets and ASX should consider whether it is now

necessary to reconsider these changes as part of CHES Replacement, as previously raised at the Business Committee.

Members seek clarity that the changes for legal name on title through clearing and settlement and the consideration for the removal of the settlement entrepot, will not further entrench these barriers to entry for new General Clearing members, nor limit flexible business models for participants. CHES Replacement should contemplate flexible participant membership, where separate legal entities may facilitate trading, clearing, DVP settlement and asset registration.

Non-Functional Requirements

Response to Consultation Questions

Q6. Are there any non-functional requirements or connectivity models you would like ASX to consider for the replacement of CHES?

Members consider that the proposed non-functional requirements have been adequately considered.

Regulatory Requirements

CHES Replacement should not exceed the current regulatory requirements. To the extent that CHES Replacement is likely to change an approach for regulatory reporting or surveillance, or take future needs into account, then Members would welcome further engagement to understand these changes.

Connectivity Models

Connectivity models should contemplate wholly remote connectivity to CHES Replacement for existing and future participants.

Introduction of ISO 20022 Message Standards

Response to Consultation Questions

Q7. Would you expect the adoption of ISO 20022 messaging standards to provide a net benefit to your organisation? If so, how would you categorise the significance of the net benefit –small / medium / large?

If possible, please provide a quantification of the expected costs and benefits of the

implementation of ISO 20022 messaging standards.

The migration to global ISO20022 standards is recognised by Global Members as a necessary improvement for the Australian market to increase competitiveness and work towards international alignment and integration.

Global Members support ISO 20022 as it could be a significant net benefit to the industry, conditioned upon operating models and business flows being correctly designed. This will allow Global Members to realise cost savings from integration into global systems, leverage existing Swift and ISO capabilities, remove local infrastructure and further regionalise post-trade processing for Australian markets.

Should ASX retain a deeply “Australian way” with high variation on global processing models, then Members will fail to realise these integration benefits and migration will be a net cost. Vendors are also unlikely to achieve scale from existing ISO 20022 capabilities for the same reasons.

For Domestic Members, there is little to be gained in the way of scale or integration from the adoption of international standards and this represents a high cost of conversion. Careful consideration around transition support and compensation could mitigate the impact to local Members and ensure Australia continues to have a strong and dynamic domestic firm presence. Domestic Members encourage further engagement on specific arrangements for local firms.

Many members recognise the limits of current proprietary CHES messaging in terms of costs and complexities in managing change and innovation. All members recognise the need to rationalise the existing suite of 500 core CHES messages (noting the exclusion of mFund messages) prior to the migration towards international standards. Members are pleased to understand this process is currently underway; noting, however, the impact cannot be determined until the final target state is known.

Members welcome further detailed technical engagement with Vendors and Members to ensure operating models and business flows are correctly designed to optimise global integration opportunities and maximise scalability of existing ISO20022 capabilities in Vendors and Members systems.

Members encourage active and periodic review with vendors and CS Participants to

ensure no final decisions are made without their guiding input.

It is noted that in many global markets clearing messages are FIX standard. Further consideration should be given to the use of FIX for Clearing messaging and ISO Settlement messages.

Q8. How important is it to your organisation that ASX continues to support CHESSESS messaging for a period of time to allow for your organisation's transition to ISO 20022 standards?

Members support limited transition arrangements to ensure CS participants can effectively manage vendor negotiations, upgrades and potentially consider outsourcing arrangements or changes to their business models.

Members understand that the trade off is that this may limit the ability to deliver future phases of CHESSESS post Day 1 and expect all future changes to be made in ISO 20022 messaging only.

It is expected that transition arrangements should be further negotiated based on the expected changes identified in Question 1, which ensure CS participants realise a net benefit for CHESSESS Replacement Day 1.

To make these changes, Members require a significant transition period that would comprise either:

- A period of four years from the decision on CHESSESS Replacement (expected in December 2017); or
- A period of three years from the final formal specification of the ISO20022 messages expected with CHESSESS.

Some members believe that those with greater capability should be able to accelerate delivery of these standards. Should a full conversion from Day 1 be required on shorter timeframes than indicated above, then there will need to be the provision of a translator service. ASX should engage Members and Vendors on the most appropriate arrangements, including commercial alternatives to the ASX.

Q9. ASX currently supplies and supports two client-side CHESSESS messaging gateways – CHESSESS PC and CHESSESS Access. Are you a user of either of these services? If so, which gateway do you use?

ASX should reference its internal records to identify the use of these services.

Q10. If you are a user of CHES PC or CHES Access, would you be seeking continuation of this gateway service from ASX (for either CHES or ISO 20022 message suites)?

CHES Gateways should be continued to the extent that transition arrangements will be required for CHES.

Q11. Does your organisation have the capability to support and migrate to ISO 20022 messaging now? If yes, what business categories do you use? If your organisation does not currently have this capability, does it have plans to implement it in the near to medium term?

ISO 20022 capabilities are limited to Global Members with custody operations and those who operate in markets where ISO 20022 is already adopted for corporate actions and settlement messaging. A limited number of members have the capability to support a migration to ISO 20022 now or in the near term.

Q12. If ASX was to mandate the use of ISO 20022 securities messaging, how long would your organisation need to migrate to ISO 20022?

Vendors are critical partners in facilitating transition arrangements and in confirming minimum timeframes that can be supported. The answers will depend on the implementation approach taken by ASX.

It is noted that a number of Members believe that transition periods should be limited, and that a hard deadline should be set for mandatory migration to ISO20022 for the whole of market.

A minority of Members could migrate to ISO 20022 in as little as six to nine months, should the business and processing models mirror global processes. Most Members would require significantly longer time periods to accommodate ISO migration.

Members recommend a transition period as set out in Question 8. Compensatory arrangements could be agreed to facilitate shorter migration periods.

ASX should recognise that many firms vendor contract cycles can extend to 5 years. Some firms may also be considering business model changes as part of CS Infrastructure changes, preferring outsourcing or hosted solutions.

Q13. Do you have a preference about the approach to the implementation of ISO 20022 messaging- for example, a big bang approach or per business function or other?

Further technical engagement is sought with vendors before a final determination can be made on an implementation approach. ASX should provide guidance based on the experience of other international migrations to ISO20022, noting the differing starting points (ie local proprietary messaging or ISO15022).

One suggested approach would be a participant-by-participant migration. Those global firms with ISO20022 capabilities would be best placed to migrate in the earliest periods. This approach would be consistent with expected transition arrangements for CHES /CHES messaging.

Q14. Does your organisation have a preference for the network used for ISO 20022 messages-for example, SWIFTNet, ASX Net or other?

For Global Members, SWIFTnet is the preferred secure communications network and many firms already have membership. It may be necessary that ASX Net continue to be available after CHES Replacement until the end of the transition arrangements for CHES.

More detailed consideration should be given to local Members access and membership arrangements for SWIFTNet or alternative vendor arrangements for connectivity into SWIFTNet. Guidance from ASX would be welcome.

Other Requirements and Considerations

Response to Consultation Questions

Q15. Please provide your views on the potential enhancements and new services identified in this paper. Would these enhancements and new services be beneficial to your organisation?

Please refer to Question 1 for Member's first order priorities for enhancements that have not been identified in the consultation paper.

We also refer you to Questions 3 and 4, which cover Member's responses to the proposed enhancements included in the consultation paper. With the exception of ISO and API access, these should be considered lower order priorities.

In the consultation paper, ASX considers systems capabilities that may be delivered in future phases of the replacement system. Members welcome ongoing engagement through the Business Committee to ensure that future phases are clearly prioritised and committed timelines are established on what is expected to be a 5-10 year journey.

Multi CCY and Multi Asset

Members support the consideration for multi-currency capability in the replacement system.

Members also support a multi-asset capability in future phases, as this would allow some CS participants to realise savings in access and infrastructure costs by having common settlement facilities for Debt and Equity. This benefit is likely to be limited to global broker dealers and Custodians. Local Members would have limited benefits from multi-asset capabilities. Members would welcome clarity on an expected approach for harmonization requirements for operating models and account structures to ensure these benefits can be realised.

Centralised Capture of Regulatory KYC information

Members do not support mandatory centralised capture and storage of KYC and AML information in the CHES Replacement system. This is not core to the provision of clearing and settlement services and risks duplicating information capture and storage already managed by CS participants.

Members recognise that there could be a realisable benefit from industry solutions to KYC, AML/CTF, FATCA and CRS regulatory requirements and the adoption of data standards and digital identification. There are a number of competitive commercial and industry utility solutions evolving to meet these needs. A whole of market utility solution that meets the wide diversity of financial market needs is desirable over an equities-only solution for Australia provided by ASX.

Q16. Please outline any additional significant functional enhancements and new services that your organisation thinks should be considered.

Please refer to Question 1 for Member's priority enhancements that have not been identified in this paper.

Q17. Do you have any other comments on the matters discussed in this paper?

Options Markets

Members would appreciate an update on the status of clearing platform replacement strategy announced in March 2016, which proposed a single clearing platform for options and equity (Nasdaq). Current inefficiencies in margin process and collateral have significant impact on CS Participants. Members would welcome the opportunity to review how improvements can be realised through CHES Replacement. To achieve this, we seek clarity on an expected approach for harmonisation requirements for operating models and account structures.

Timeframes

As a matter of urgency ASX should communicate realistic and achievable timelines for CHES Replacement beyond December 2017. Members indicate that, without committed target dates for CHES Replacement, they cannot plan for strategic business opportunities or changes. Some Members and Vendors will be considering potentially significant changes to their business models.

Members would welcome feedback from this consultation period by mid December. After further consultation as indicated, Members request that a definitive view of the target state for CHES Replacement Day 1 be published as soon as practicable. Members request that ASX articulate accountability arrangements for Day 1 and committed phases as part of CHES Replacement.

Operating Cost Efficiencies

It should be noted that financial market conditions remain competitive and commission rates earned by brokers have halved over the past decade. Despite this; exchange, clearing and settlement fees have reduced only marginally and represent an ever-increasing proportion of broker costs. Members feel that any initiative for CHES Replacement must redress this imbalance in costs and hence commercial returns for brokers.

In line with COFR Regulatory Expectations, Members request that ASX demonstrate how CHES Replacement will both meet efficient costs and fair pricing expectations. The replacement system must be cost effective to operate, support and enhance. Members recommend a target objective be set to achieve a minimum 20% reduction in costs for ASX Clear, ASX Settlement and CS Participants for CHES Replacement Day 1. To be clear, CS Participants costs refer explicitly to aggregate fees paid for clearing and settlement services.

Members feel cost reduction targets can only be achieved by focusing on core clearing and settlement services. To this end, Members request that ASX provide full transparency on the capital investment costs and demonstrate priority in delivering these services to the Business Committee.

COFR Regulatory expectations allow ASX to set pricing with reference to a commercial return on investment commensurate with the commercial risks involved. While Members support ASX's right to commercial returns, this raises concerns on the potential for cost escalations on the investment that will ultimately drive up prices for CS Participants.

In setting pricing in line with COFR Regulatory expectations, costs should be fair and represent efficient costs of providing these services. In the consideration of CHES Replacement, members request a commitment that if transaction messages are removed, ASX should not seek to recover lost revenue by increasing costs of other transaction messages. Where a change of processing increases message volumes (eg moving from net to gross) then transaction cost in aggregate should remain neutral.

mFund

The majority of Members do not support mFund as part of CHES Replacement Day1; mFund is not a core clearing and settlement service. The inclusion of mFund services creates a significant burden for Vendors given the high volume of messages required for the mFund transition to ISO standards. This would add to the overall risk and cost of CHES Replacement.

mFund could be considered as a future phase and managed within the transition arrangements for CHES. Members welcome further review of intended workflows and processes.

User Governance & Independent Validation for DLT

Members welcome the COFR Regulatory Expectations for user input into governance arrangements that requires input from the users of CS infrastructure into the setting of the investment strategy. Members believe that, in line with COFR Regulatory Expectations, the Business Committee should be required to endorse ASX's decision to implement DLT, along with core principles and timeframes for CHES Replacement.

Members further request that ASX provide independent validation on the decision to support DLT for CHES Replacement to the Business Committee. Independent assessment should ensure that the DLT solution would meet all functional and non-functional requirements as well as the principles and objectives for CHES Replacement. ASX has an investment in Digital Asset Holdings, the providers of the expected DLT solution. Therefore, independent third party validation is essential.

Risks Mitigation for CHES Replacement: No Alternative

ASX is evaluating the use of DLT for CHES Replacement and is believed to have already commenced the build, in partnership with Digital Asset Holdings. The consultation paper does not contemplate an alternative as being considered. Should an independent decision in December 2017 conclude that the DLT is not appropriate, then there is a significant risk of material delays for the replacement of CS Infrastructure given there is no alternative being indicated.

Members note that many of the expected changes or business requirements are not dependent on the implementation of DLT. Members also seek transparency on whether conventional technology could deliver equivalent results, but for a lower cost and risk to Industry. Risk mitigation considerations being contemplated for CHES Replacement should be shared with the Business Committee.

The innovative potential of DLT has been greatly anticipated by Members who welcome the opportunity to consider its application in equity clearing and settlement. Members note, however, that many international discussion papers indicate that the full potential of DLT (significantly reducing operating costs and risk) can only be realised through strong industry collaboration. Continued engagement with Industry stakeholders is, therefore, welcomed.

Members understand that open questions remain when considering ISO20022

standards for use with DLT. There is potential for DLT to eliminate the need for point-to-point messaging or potentially eliminate information requirements in the messages. A recent Swift Information Paper: *Distributed Ledgers, Smart Contracts, Business Standards and ISO 20022 September 2016*; indicated that attempting to impose standards too soon – before the capabilities and constraints of a technology are understood – risks creating standards that are quickly obsolete and irrelevant. Members appreciate that ASX may still be investigating ISO20022 with DLT and would welcome further discussion on risk mitigations through Technical Committees and the Business Committee.

CHES Services

The consultation for CHES Replacement contemplates three services for CHES: Clearing, DVP Settlement and Asset Registration. Elements of a fourth category, Issuer Administration Services, have been discussed in parts of the consultation paper but have not been identified as a discreet service. ALMOs require access to DVP Settlement, Asset Registration (asset owners benefit from these services) and Issuer Administration Services (Issuers benefit from these services). ALMO Members request a clear demarcation be made between these four services and that ASX address the COFR regulatory expectations in all service lines.