

17 March 2021

Email: chessreplacement@asx.com.au

Keith Purdie
ASX Limited
20 Bridge Street
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Dear Keith

CHESSE REPLACEMENT: PROPOSED CHANGES TO NETTING AND SETTLEMENT WORKFLOW

The Stockbrokers and Financial Advisers Association (SAFAA) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and Advisory firms which provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

Our members include clearing and settlement and settlement only participants ('participants').

Thank you for the opportunity to provide feedback on the proposed modifications to the CHESSE replacement system to support the registration and clearing and settlement of significantly greater trading volumes than originally anticipated.

We note that ASX is proposing changes to the design of both the netting process (including removal of the creation of the Net Broker Obligation settlement instruction) and settlement confirmation workflows that will impact clearing and settlement and settlement only participants as well as software providers and approved market operators.

Overview

SAFAA is concerned that this fundamental change is being implemented at such a late stage in the CHESSE replacement project, only two years prior to go live date. We understand that the proposed change is a reinvention of the way the system operates and will require significant changes to systems, processes and work that has already been completed by participants and that will need to be redone. In turn, this introduces additional costs. Furthermore, all additional change at this stage in the project incurs additional delivery risk.

Under the proposal, essentially participants are being required to undertake additional processing which in turn creates additional operation risk when their original expectation would have been that the new CHESSE system would deliver like for like on this aspect.

There are still many unknowns regarding various aspects of the proposals, such as the impact the changes will have on development time and the risks that the proposals pose to participants and their clients. While the one-

month consultation period has been sufficient for many participants to understand the proposed changes and undertake some analysis of likely impact, it has not been sufficient time for them to develop a detailed analysis of all the changes to systems that will be required to accommodate the new process and message flows outlined in the paper.

We note that ASX has yet to provide participants with a risk assessment of the proposal, which is a major industry change. SAFAA considers that this affects the ability of participants to fully understand the impacts of these proposed changes and to provide an informed response. SAFAA encourages ASX to make a risk assessment available to participants as part of the consultation process to enable them to more appropriately assess the risks and costs of these proposals and their impact on the delivery schedule.

Of grave concern is that ASX's proposal will result in a significant increase in operational risk for participants as they will no longer be provided with an auditable settlement chain to definitively identify the settlement obligations being netted and fully settled. Instead, as we understand it, participants will be required to self-determine settlement finality by performing additional processing, reconciliation and verification activities for a large volume of client transactions during business hours. This may also have indirect impacts on other high volume/complex functions performed by participants such as determining client money obligations and processing of client orders for pre-trade and post-trade units. Such indirect impacts have not been considered in project estimations to date and will require significant analysis of a combined vendor and ASX solution to determine if the day one milestones for CHES replacement are still achievable.

We have obtained the following specific feedback from our members on the relevant issues raised in the consultation paper.

Detailed comments

Question 1 For impacted participants, what impacts do the proposed changes have on your overall business processes, operations and systems (eg. Cessation of Net Broker Obligation, introduction of Novated Net Delivery Position, and/or the settlement confirmation changes)?

SAFAA is supportive of the ASX's aim to simplify and reduce the number of messages along with the processing required. However, the changes that the proposed new flows and messaging will impose on systems and processes are significant. We have identified the following issues:

- Most of the functionality that is proposed to changes has already been built and tested in systems, resulting in significant rework and additional cost. For example, the removal of the Net Broker Obligation, allowing gross market trades to remain outstanding as settlement obligations until the point of settlement, requires significant rework of functionality that has already been built. It is important to note that while the proposed changes reduce the processing required on the ASX side, they increase the processing required by participants. Our members reiterate the need to see the risk assessment in order to understand the rationale for reducing processing for ASX but increasing it for participants.
- The move to assumed settlement of all outstanding obligations with only a summary confirmation message (and the NRI & NSF for fails) has potentially much larger impacts on our members' existing systems and processes. This may cause logistics and operations issues, especially if instances occur when the totals presented on the Novated Net Delivery Position and settlement confirmation messages don't match the underlying settlement obligations calculated by the participant. This may require remediation action to be taken to close out settlement where these exceptions are encountered. While the new settlement detail demand report will allow participants to manually investigate issues when they arise,

this is not an automated solution and will be significantly slower than existing processes where participants currently receive explicit messages per gross trade. Effectively this leaves a gap for participants and introduces significant operational risk in the case of an issue impacting multiple securities, potentially delaying critical post settlement processes in a way not encountered today.

- By moving away from a message at a holder level to a Settlement Statement Report from a different source at a Financial Product level, we have concerns that there will be timing issues for participants performing their reconciliations.
- Significant changes will be required to systems to provide the solutions. For example, in order to verify that counts and totals on the Novated Net Delivery Position and settlement confirmation messages match the settlement obligations, participants will need to build additional netting logic into their systems (as currently they are provided with details of the trades that make up a Net Broker Obligation).
- The increased corporate action messaging on a gross basis may impact on quarterly bank dividend season.

Question 2 For impacted participants and software providers (third party vendors and those developing in-house), can the proposed solution design be enhanced or supplemented to assist with the implications of the proposed changes for existing business processes, operations and systems?

SAFAA makes the following recommendations to assist with the implementation of the proposal:

- ASX include the IDs of the individual settlement obligations (ie the gross market trades and USSI/BSSIs included in the counts/totals on a given settlement confirmation message) to reduce the level of change required for participants and the level of delivery and operational risk.
- The Settlement Detail Demand Report includes sufficient detail to prove that settlement of a specific transaction has occurred between two different participants, (currently represented on the existing MT156), confirming settlement between the two specific transaction IDs of each participant.
- Users be able to query the ledger after batch completion to confirm settlement of individual transactions in bulk. This may be more useful than an adhoc Settlement Detail Demand Report if a reconciliation issue is detected between the Net Settlement from CHESS and a participant's calculation of their Net Settlement.
- Participants be provided with a more comprehensive set of worked examples and scenarios that explore the edge cases in the proposed new processes. Members have advised that those provided at the recent Focus Group for Clearing and Settlement Participants were not as clear as they could have been.
- While extending the trade cancellation cut off is welcome, it should not be extended beyond T+1. This is to allow operations staff sufficient time to readjust funding or stock positions to prepare for final settlement.

Question 3 For impacted participants and software providers, what impacts do the proposed changes have on your organisation's technical readiness activities for accreditation commencing from late April 2022 and/or operational readiness activities commencing from September 2022?

The one-month consultation period has not been sufficiently long enough to allow members to develop a detailed analysis of all of the changes to systems that will be required to accommodate the proposed new process and message flows.

Additional change at this stage of the project incurs additional delivery risk. While members expect to be able to complete the required work to accommodate the changes for the New Broker Obligation redesign in time for

technical accreditation activities in April 2022, the more changes they have to accommodate, the bigger the risk. Including the IDs of the settlement obligations (ie the gross market trades and USSI/BSSIs) included in the counts/totals on a given settlement confirmation message would reduce the level of change required for participants and reduce the level of delivery risk.

Conclusion

SAFAA is concerned that the proposal introduces significant costs and delivery and operational risk to the CHES replacement project for participants. We are strongly of the view that until ASX releases a risk assessment, it is difficult for participants to assess fully the risks and costs of these proposals and their impact on the delivery schedule.

Our members would welcome further discussion with ASX ahead of the release of the consultation response to discuss their concerns in more detail.

Kind regards

A handwritten signature in black ink, appearing to be 'J Fox', with a long horizontal stroke extending to the right.

Judith Fox
Chief Executive Officer