



18 March 2021

Keith Purdie  
ASX Limited  
20 Bridge Street  
Sydney NSW 2000

By email: [chessreplacement@asx.com.au](mailto:chessreplacement@asx.com.au)

Dear Mr Purdie

**Re: AFMA submission on CHES Replacement: Proposed changes to netting and settlement workflow**

The Australian Financial Markets Association (AFMA) welcomes the opportunity to provide comment to the ASX on the proposed changes to netting and settlement workflow as part of CHES Replacement. We represent a wide range of market participants that will be impacted by the changes.

AFMA supports ASX's main objective to allow the CHES replacement system to scale to much higher volumes than previously envisaged. The volume spikes in 2020 demonstrated the need to plan carefully for future capacity increases. We also recognise some of the potential benefits of the proposed changes in reducing processing messaging volumes, de-risking critical settlement processes and allowing trade legs to persist individually until batch settlement (noting some concerns around allowing cancellation on the day of settlement).

Under the revised proposal, brokers must do their own estimation of the settlement state of trades in the CHES replacement system and rely on reconciliation processes to manage potential breaks between settlement agreed with clients and what has actually been settled within the CHES replacement system. This is different to what was previously proposed by ASX and currently provided by CHES. The removal of this currently available functionality increases risks for clearing and settlement participants and introduces the need for reconciliation processes to ensure these risks are mitigated.

The proposals represent a substantial design change to the affected systems, will require the restructure of operations processes and will have substantial software development impacts for software vendors (and market participants that use internal systems for clearing and settlement connections) at a relatively late stage of the CHES replacement project.

In AFMA's view, the proposed changes do not appear to fully consider the extent of risks and rework costs to vendors, market participants and their clients. These risks and costs may feed into further project delivery risks.

AFMA would support ASX broadening the range of alternative scaling solutions under consideration in consultation with clearing and settlement participants. This need not be a formal consultation paper but could be done through a dialogue process.

Given the system-wide changes involved, AFMA supports an external comprehensive risk analysis of the proposed new system. This would ensure any additional risks introduced into the clearing and settlement processes for both the exchange and clearing members are fully understood and managed from day one.

AFMA's submission highlights the implications of the proposed changes for market participants and the risks thereof. We welcome further engagement with the ASX to appropriately and efficiently address the industry's concerns.

We thank you for considering our comments. Please feel free to contact us via the Secretariat should you have questions about our response.

Yours sincerely

A handwritten signature in black ink that reads "Damian Jeffree". The signature is written in a cursive style with a large initial 'D' and a long, sweeping underline.

Damian Jeffree

**Senior Director of Policy**

## Responses to consultative questions

1. *For impacted participants, what impacts do the proposed changes have on your overall business processes, operations, and systems (e.g. cessation of NBO, introduction of NNDP, and/or the settlement confirmation changes)?*

While the removal of NBO and reduction in related messages adds efficiencies by simplifying trade processing within the ASX's environment, the new processing flows related to the NNDP reports are expected to impose major changes on participants' systems to allow for the new functionality, and make them consequently less efficient. We note that the changes are likely to be costly and resource intensive as they would replace functionality that has already been built and tested extensively. While processing burdens may reduce for the ASX, they will increase for market participants.

The proposed shift to notifying summary settlement confirmations on an exception basis of only the total funds settled along with Novated Settlement Failure (NSF) and Novated Rescheduled Instruction (NRI) will require modifications to system functionalities and may lead to critical risks.

Potential operational concerns may arise in the event that the total funds on the Novated Net Delivery Position (NNDP) and settlement confirmation messages do not equal the underlying settlement obligations that market participants understand to be outstanding. This will necessitate action to resolve settlement where these inconsistencies occur. In terms of operational capacity, participants would need to rebuild and test additional logic and functionality into their systems which has significant associated cost.

While the proposed on-demand settlement statement report will detail the underlying instructions that make up the settlement, participants will need to manually track issues as they emerge using additional processing, reconciliation and verification. For corporate action adjustments, the current functionality where participants receive reconciliation reports from the ASX is important. Under the proposed changes, the manual reconciliation will be slower than the automated resolution currently available where participants receive clear messages per gross trade. This may lead to new and considerable operational risks if an issue affects multiple securities and may cause delays in key post settlement processes.

AFMA recommends the ASX consider moving adjusted obligations to an explicit net obligation to prevent the risk highlighted above. Further, the NNDP can be distributed before adjustments are instructed so participants can reconcile their net obligations on a pre-adjustment basis.

This fundamental system-wide restructuring comes with substantial costs to the industry. Market participants face indirect flow-on impacts and risks for other complex functions such as settling high volume client money obligations. These indirect impacts need to be considered holistically for clearing and settlement processes for both the exchange and clearing members to ascertain if the initial checkpoints for the CHES replacement project are still attainable and feasible. AFMA supports an external comprehensive risk analysis of the proposed new system including how it would operate at clearing brokers.

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?*

As outlined above, we note the several substantial changes to the systems and processes and the related costs for implementing the proposed changes to netting and settlement workflows.

AFMA suggests that the ASX considers alternative solutions to meet the scalability objectives. In consultation with clearing and settlement participants if possible, clearing participants would prefer options that do not require such fundamental changes to existing and tested system functionalities.

If the ASX were to proceed with these changes, AFMA would support introducing logical efficiencies and adjustments that will reduce the resource burdens on market participants and help them manage operational risks which will result from the changes.

For instance, ASX may wish to consider including the identifiers of the individual settlement obligations i.e., the gross market trades and USSIs or BSSIs could be included in the totals on a given settlement confirmation message to reduce the level of manual reconciliation required for participants and in turn, the level of delivery risk and operational risk as highlighted above.

For participants with additional risk management requirements apart from ASX's Settlement Operating Rules, finality of settlement can only be met through reconciliation against source system data such as the current EIS156 message. We support an ability for the participants to query the ledger after batch completion to confirm settlement of individual transactions in bulk. This may be more efficient than an only ad-hoc Settlement Detail Demand Report to investigate a reconciliation issue between the Net Settlement from CHES and a participant's calculation of their Net Settlement. This may risk a gap for participants and if not dealt with, would affect their obligations around settlement finality.

AFMA supports a comprehensive risk analysis and worked examples which include scenarios that explore a wide range of impacts of the proposed processes. The industry would benefit from receiving a comprehensive assessment to allow vendors and participants to appraise the risks, costs and delivery timelines more thoroughly.

- 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?*

Though the consultation period has allowed market participants to understand and undertake an initial analysis of the proposed changes, there has not yet been time to develop a full understanding of the design changes required to systems, resultant processes and message flows to implement them.

Additional changes expand this far into the project, increase additional delivery risks.

- 4. For AMOs, do you see benefit in allowing for trade cancellation after trade date for trades executed on your market?*

In AFMA's view allowing AMOs to issue trade cancellations up to the settlement date adds considerable operational risk to settlement projections and to participant cash market

margin obligations. Restricting the ability of AMOs to cancel trade executions to no later than close of business S-1 would allow the NNDP to precisely indicate projected settlements. This restriction would provide a far preferable risk profile outcome.