



ASIC
Australian Securities &
Investments Commission

PJC on Corporations and Financial Services Inquiry into the CHES Replacement Project

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Overview

- 1 The ASX Group operates critical financial market infrastructure and related services in Australia. ASX Clear Pty Ltd and ASX Settlement Pty Ltd provide monopoly cash equities clearing and settlement (CS) facility services. They facilitate the clearing and settlement of trades in both ASX-listed and non-ASX listed securities through CHES. ASX is replacing the ageing post-trade cash equities CHES platform.
- 2 On 17 November 2022, ASX announced that it had paused the CHES Replacement Project. This followed the completion of an external review into aspects of the project including the delivery of the remaining CHES replacement application software (the External Review), and an internal ASX assessment. ASX is now reconsidering the solution design of the CHES replacement system. ASX must carefully evaluate and select the most appropriate and timely way forward to replace CHES.
- 3 ASIC continues to work closely with the RBA (the Regulators) to respectively monitor ASX's compliance with its CS facility licence obligations (including the additional licence obligations imposed on ASX in November 2021) and the RBA's Financial Stability Standards (FSS). ASIC has used its current limited powers (including delegated powers) to set regulatory expectations, impose additional licence conditions on ASX, appoint independent experts and require special reports and audit reports on a number of matters, including the ongoing operation, security and continuity of the current CHES.
- 4 It is important for ASX, industry, the Australian financial system and the reputation of Australia globally that ASX has a smooth and successful transition to a CHES replacement system. However, ASIC and the RBA require stronger powers to enhance their supervision of ASX and the ACCC requires new arbitration powers to conduct binding arbitration to resolve disputes regarding access to CS services. ASIC with the other Council of Financial Regulators' agencies advised Government in 2015 and 2020 on much needed reforms to ensure Australia has a fit for purpose regulatory regime for ASX and, more broadly, Australian financial market infrastructure (FMI). These reforms for competition in clearing and settlement (CiCS) and the FMI reforms would provide much needed powers to ensure ASX's compliance with the Regulators' expectations and regulatory regime. ASIC welcomes the Government's commitment to implementing these reforms and stands ready to work with Government to facilitate competitive outcomes in the provision of CS services and ensure the resilience of Australia's critical FMI.
- 5 ASIC will continue to use all currently available regulatory measures to ensure ASX complies with its licence obligations and meets regulatory expectations.

A Background

Key points

The ASX Group is a vertically integrated exchange that provides critical financial market infrastructure and related services to Australia's financial system. ASX Clear Pty Ltd and ASX Settlement Pty Ltd provide monopoly cash equity CS facility services in Australia.

Internationally, clearing and settlement arrangements and market structures vary. There is a mix of vertically integrated exchange groups and exchanges that use third party clearing and settlement providers.

CHESS is a critical piece of national infrastructure that, despite its high standard of settlement performance, is an ageing technology.

ASIC and the RBA are jointly responsible for the supervision of ASX's clearing and settlement facilities. ASIC continues to use its powers and works closely with the RBA to monitor ASX's compliance with its licence obligations.

History and importance of ASX

- 6 The ASX Group is a vertically integrated exchange that provides critical services to Australia's financial system. ASX is either the dominant or sole provider of a range of critical financial market infrastructure and related services in Australia, and by facilitating the flow of capital and risk management, it plays a central role in the growth and prosperity of the economy.
- 7 The ASX was incorporated under legislation in 1987, amalgamating the six state securities exchanges. It was the first exchange in the world to demutualise and directly list on itself on 14 October 1998. Prior to this, financial markets in Australia were operated through a not-for-profit, mutual ownership model. International counterparts soon followed. In 2006, the ASX merged with Australia's other major market, the Sydney Futures Exchange.
- 8 ASX Limited holds an Australian market licence and is a tier 1 market venue. Tier 1 market venues are significant to the Australian economy and the efficiency and integrity of, and investor confidence in, the financial system. It is Australia's primary listing cash equity market operator and is responsible for the listing of securities on its market.

- 9 ASX Clear Pty Ltd (ASX Clear) and ASX Settlement Pty Ltd (ASX Settlement) are CS facility licensees and wholly owned subsidiaries of ASX Limited. The ASX Group also includes two other CS facility licensees: ASX Clear (Futures) Pty Ltd and Austraclear Ltd.
- 10 A clearing and settlement facility is a facility that clears and settles transactions in financial products such as cash equities, bonds and derivatives.¹ CS facilities include central counterparties, securities settlement facilities and central securities depositories. CS facilities are crucial to supporting confident and informed participation by investors in Australia's financial markets and are critical to the functioning and stability of the Australian financial system.
- 11 Australia's financial system is critically reliant on the ASX Group's CS facilities. If these facilities services were disrupted or there was a failure of its operations, this would severely undermine the operation of the financial system. Australian financial markets, banks, insurers, superannuation funds and other financial services firms rely on CS facilities to undertake their respective operations.
- 12 ASX Clear and ASX Settlement provide monopoly cash equities CS facility services in Australia, facilitating the clearing and settlement of trades in both ASX-listed and non-ASX listed securities. There is competition in the listing and secondary trading of cash equity securities, including between the ASX market, Cboe Australia Pty Ltd (Cboe Australia), National Stock Exchange of Australia Limited (NSX) and Sydney Stock Exchange Limited (SSX). However, currently only ASX Clear and ASX Settlement are licensed to clear and settle cash equities in Australia. These markets are therefore reliant on ASX Clear and ASX Settlement to operate their respective markets.

International context

- 13 International clearing and settlement arrangements and market structures vary. There is a mix of vertically integrated exchange groups and exchanges that use third party clearing and settlement providers.
- 14 Singapore's SGX, Japan's Japan Exchange Group and Canada's TMX Group, like the ASX, are vertically integrated exchanges. In the UK, the London Stock Exchange Group is vertically integrated, with its subsidiary LCH Limited (LCH) and related entities operating multi-national clearing houses. LCH is also one of the world's leading clearing houses, and

¹ The legislative definition can be found in s.768A of the *Corporations Act 2001* (Cth)

services major international exchanges and platforms, as well as a range of over-the-counter markets.

- 15 In the US, the Depository Trust and Clearing Corporation (DTCC) together with its subsidiaries provides clearing and settlement services to most of the US securities market. While the New York Stock Exchange and the NASDAQ are considered to be vertically integrated exchanges, they still typically rely on DTCC for post-trade services. Other US stock exchanges such as Cboe and Investors Exchange LLC (IEX) also rely on third-party clearing and settlement facility providers.
- 16 In Europe there is greater competition in clearing from third party providers. While LCH is a dominant clearing house, EuroCCP (a subsidiary of Cboe Global Markets) is a leading clearing house primarily for European equity markets. Deutsche Börse's vertically integrated business offers clearing and settlement services through its subsidiaries including Eurex Clearing.
- 17 In most major economies, there is typically a limited number of providers of CS facility services, and in some there is only one. In some circumstances and markets a single provider may be able to provide the services at a lower cost than multiple providers could. Clearing and settlement facility services require significant upfront and ongoing investments in technology, infrastructure, and regulatory compliance.

CHES background

- 18 Australia was one of the first countries in the world to introduce electronic stock trading in 1987. Before the first automated stock trading system (SEATS), the stock exchange was manual, relying on the trading floor and board posting.
- 19 In 1993, the FAST system of accelerated settlement was introduced, to be progressively replaced with the Clearing House Electronic Sub-register System (CHES). Phase 1 of CHES in 1994 provided an electronic transfer system and electronic sub-register. The majority of the current CHES was implemented in Phase 2 in 1996 with settlement on a delivery versus payment basis being the key change.
- 20 The development of CHES enabled the successful conversion of physical shares into an electronic form, significantly improved the efficiency and effectiveness of post-trade processing in Australia, and significantly reduced settlement risk. At the time, the technology was world leading. To this day CHES continues to have a globally low daily settlement failure rate. CHES underpins the operation of ASX Clear and ASX Settlement's

cash equity CS facilities and is systemically important financial market infrastructure.

- 21 Despite CHESS's high standard of settlement performance, it is an ageing technology. As a critical piece of infrastructure, given ASX's decision to pause the CHESS Replacement Project, ASIC's immediate regulatory priority is to ensure current CHESS is supported and maintained to ensure its stability, resilience and longevity to continue to service the Australian cash equity market reliably until it is replaced by an effective and reliable replacement system. We continue to work closely with the RBA as we monitor ASX's compliance against its CS facility licence obligations and the FSS.

Joint supervision of ASX CS facilities by ASIC and the RBA

- 22 ASIC and the RBA co-supervise licensed CS facilities under Part 7.3 of the *Corporations Act 2001* (Cth) (the Act). We have separate but complementary regulatory responsibilities and work closely to coordinate supervisory activities.
- 23 Under the co-supervisory model, ASIC is responsible for assessing whether a CS facility's services are provided in a fair and effective way. The RBA is responsible for ensuring that licensed CS facilities conduct their affairs in a way that is consistent with financial system stability. This division reflects the regulators' particular mandates. The focus on the fair provision of services in ASIC's mandate includes but is not limited to concepts such as disclosure (e.g. in relation to risks and fees), level playing field between large and small participants, and governance arrangements for a CS facility.
- 24 The RBA has supervisory responsibilities for financial stability, including setting FSS for CS facilities and assessing CS facilities against those standards. A CS facility licensee must comply with the FSS and do all other things necessary to reduce systemic risk.
- 25 ASIC also separately has regulatory and supervisory responsibilities for other FMI including operators of licensed markets, including the ASX market. More broadly FMIs include financial market operators, benchmark administrators, clearing and settlement facilities and derivative trade repositories. FMIs are key operators of market infrastructure that enable, facilitate and support trading in Australia's capital markets.

ASIC's current powers to supervise ASX Clear and ASX Settlement

- 26 Currently under Part 7.3 of the Corporations Act, and as set out in Regulatory Guidance² ASIC is empowered to regulate CS facilities by:
- (a) advising the Minister about:
 - (i) applications for a CS facility licence (s824A(2), 827B);
 - (ii) applications for a CS facility licence exemption (s820C(1));
 - (iii) changes to operating rules (s822D, 822E); and (iv) other matters for which the Minister has a discretion under Pt 7.3. For example ASIC may advise the Minister of a licensee's breach of their obligations (s821B(1));
 - (b) assessing and reporting to the Minister on CS facility licensees' compliance with their obligations, other than the obligations relating to financial stability standards compliance and systemic risk reduction, which are assessed by the RBA (s823C);
 - (c) enforcing CS facility licensees' compliance with their obligations under the Corporations Act (s822C, 823C); and
 - (d) enforcing the prohibition on a person operating, or holding out that the person operates, a CS facility in Australia if the person does not hold a licence or an exemption (s820A, 1311(1), 1313(1)).
- 27 In April 2016, the Minister delegated to ASIC a range of market, and clearing and settlement facility regulatory powers, including the power to grant a licence, disallow changes to operating rules, suspend or cancel licences. The FMI reforms will legislate the transfer of the delegated powers to ASIC and in some specific instances to the RBA.
- 28 ASIC's exercise of the current delegated powers is subject to published guidelines which require ASIC in exercising the delegated powers to, among other things, consider competition and the Government's commitments and priorities.
- 29 As the regulators of the ASX Group, ASIC and the RBA need strong and dependable powers to carry out their mandates, and to mitigate the risk of disruption to ASX CS facility services. ASIC and the ACCC also require additional powers to facilitate competitive outcomes in the provision of CS services to financial markets. The Regulators have, through the Council of Financial Regulators (CFR) advised the Government on two proposed reform packages to address deficiencies and inefficiencies in the regulatory regime in relation to CS facilities and more broadly FMI operating in Australia. The details of the proposed reform packages are set out in Section C.

²<https://download.asic.gov.au/media/5702563/rg211-published-18-december-2012-20200727.pdf>

- 30 On 14 December 2022, the Treasurer announced that Government will act on the Council of Financial Regulator's recommendations and implement reforms to facilitate competitive outcomes in CS services and improve Australia's FMI regulatory regime. Together these reforms will provide much needed powers to ensure ASX's compliance with the regulatory regime and the Regulators' expectations of ASX with respect to current CHESS and the CHESS replacement.
- 31 ASIC does not currently have a rule-making power in relation to the ASX's CS facilities. This is in contrast to ASIC's powers to make Market Integrity Rules in relation to market operators and their participants. Both the proposed reform packages discussed in Section C will include rule-making powers for ASIC in relation to CS facility licensees. We stand ready to work with Government to implement these reforms.
- 32 Until these reforms are implemented, ASIC will use all currently available regulatory measures to ensure that ASX meets the Regulators' expectations and complies with its CS facility licence obligations. These regulatory measures include exercising powers delegated by the Minister to ASIC.

ASIC's use of current powers

- 33 Immediately following ASX's decision to pause the CHESS replacement, ASIC and the RBA published a joint letter of expectations on 17 November 2022. Our expectations are that:
- (a) current CHESS is supported and maintained to ensure its stability, resilience and longevity so that it can continue to service the market reliably
 - (b) ASX uplift its capabilities before progressing the replacement project
 - (c) ASX bring the replacement project back on track to deliver safe and reliable clearing and settlement infrastructure.³
- 34 ASIC had previously used the delegated powers to impose licence conditions on ASX Ltd, ASX Clear and ASX Settlement in November 2021.⁴ The additional licence conditions were imposed on ASX Clear and ASX Settlement, were intended to mitigate risks associated with the CHESS Replacement Project. These conditions are still in force and will remain so until the go-live date of the replacement system. Ernst & Young, as the appointed independent expert under these additional licence conditions, is expected to report to ASX and ASIC every six months up until 12 months after the CHESS replacement go-live date. For more information, please see Section B.

³ <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2022-releases/22-320mr-asic-rba-joint-statement-on-asx-chess-replacement-program/>

⁴ <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2021-releases/21-313mr-asic-imposes-additional-licence-conditions-on-asx-and-issues-expectations-to-improve-market-resilience/>

- 35 ASIC also used delegated powers to issue notices requiring ASX to provide ASIC with audited special reports. On 14 December 2022, ASIC issued notices to ASX Clear and ASX Settlement under section 823B of the Corporations Act to produce a special report on current CHES.⁵ The special report must address the operation, security, business continuity and governance arrangements of current CHES. The special report is to be audited by Ernst & Young, with the audited report due on 31 May 2023.
- 36 On 21 February 2023, ASIC issued further notices to ASX Limited, ASX Clear and ASX Settlement under sections 794B and 823B of the Corporations Act.⁶ These notices require ASX to produce two audited special reports on ASX's response to the External Review (the External Review Special Report), and ASX's portfolio, program and project management frameworks. Both of these special reports will be audited by Ernst & Young. The External Review Special Report is due to ASIC on 30 June 2023, and the associated audit report on 31 July 2023. The second special report on ASX's frameworks is due to ASIC on 29 September 2023 and the associated audit report on 31 October 2023.
- 37 ASIC considers the External Review Special Report will provide necessary assurance for ASIC and industry that ASX is taking all possible steps to respond to the findings and recommendations outlined in the External Review. More broadly an assessment of ASX's portfolio, program and project management frameworks against internationally recognised frameworks will demonstrate which components are fit-for-purpose and the measures to be adopted to address identified gaps and deficiencies. These reports will help build confidence in ASX's ability to deliver the CHES replacement and any other programs ASX undertakes.
- 38 Collectively, the audited special reports will assist ASIC in its consideration of next steps and assessment of whether any further regulatory action is required, as indicated in Section B.

⁵ <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2022-releases/22-357mr-asic-rba-further-regulatory-response-regarding-the-asx-ches-replacement-program/>

⁶ <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2023-releases/23-035mr-further-asic-regulatory-response-on-ches-replacement-and-asx-s-program-capabilities/>

B CHESS replacement

Key points

ASX is replacing the ageing CHESS platform. The replacement system must meet system availability, resilience, recoverability, performance and security requirements. The replacement of CHESS is ultimately the responsibility of ASX.

Over the life of the CHESS Replacement Project, there have been a number of delays to the replacement system's go-live date. On 17 November 2022, ASX announced a pause to the CHESS Replacement Project following an External Review which identified challenges in meeting requirements, deficiencies in the delivery model and gaps in testing, quality management and overall program management. It is important for there to be industry certainty and confidence in the way forward.

Together with the RBA, ASIC continues to closely monitor the ASX's compliance with its obligations, including additional licence conditions imposed in November 2021. ASIC will take further regulatory action if required. ASIC's immediate regulatory priority is to ensure current CHESS is supported and maintained to ensure its stability, resilience and longevity until it is replaced by an effective and reliable replacement system.

Background

- 39 ASX is replacing the ageing CHESS with a replacement system. At a minimum, the replacement system must meet requirements which CHESS meets today for system availability, resilience, recoverability, performance and security. The replacement is also expected to achieve a significant uplift in intraday trade processing capacity and end-of-day processing performance.
- 40 The replacement of CHESS is ultimately the responsibility of the ASX. ASIC's expectation is that the ASX carefully consider its obligations as the operator of critical national infrastructure and work with industry to replace CHESS with a system that meets the market requirements and expectations
- 41 ASX commenced evaluating replacement options for CHESS in 2015. On 22 January 2016, ASX selected Digital Asset Holdings, LLC (Digital Asset) as a technology partner to build and test a prototype replacement system based on distributed ledger technology (DLT).⁷ ASX subsequently issued a consultation paper on the requirements for the replacement system

⁷ <https://www2.asx.com.au/content/dam/asx/about/media-releases/2016/ASX-Selects-Digital-Asset-to-Develop-Distributed-Ledger-Technology-Solutions.pdf>

in September 2016⁸ and on 7 December 2017, ASX announced its intention replace CHESS with a DLT-based system built by Digital Asset.⁹

42 In April 2018, ASX released a public consultation paper on the new scope and implementation plan for the CHESS Replacement Project, leveraging the input gained from prior industry engagement on new and enhanced features and functions. In September 2018, ASX responded to feedback and confirmed the scope and timeline.¹⁰

43 In 2019, ASX and Digital Asset partnered with VMware, a large US-based technology firm, to deliver the DLT platform.¹¹ Digital Asset remained responsible for delivering the DLT-based application that would replace the current CHESS application (Application).

44 ASX established the CHESS Replacement Project to develop, build and deliver the replacement system.

45 Over the life of the project, there have been a number of delays to the replacement system's go-live date.

- (a) On 25 March 2020, ASX announced a delay to the original go-live date of April 2021. ASX noted this was due to COVID-19, in response to user feedback on timing, requested functionality changes, and the need for ASX to complete aspects of its own readiness.¹² ASX consulted with industry in June 2020 on a proposed revised timeline for a new go-live date of April 2022.¹³
- (b) On 28 October 2020, ASX announced a new go-live date of April 2023 for the CHESS replacement. This further delay was based on user feedback, the inclusion of additional functionality and expanded industry wide testing, and the need for greater trade processing capacity and system scalability.¹⁴
- (c) On 11 May 2022, ASX confirmed the scheduled go-live date of April 2023 was no longer viable.¹⁵ ASX noted this decision reflected the delay to the remaining delivery of application software, which no longer gave ASX and CHESS users the time allocated to complete their testing and other readiness activities before April 2023.

⁸ <https://www.asx.com.au/documents/public-consultations/ASX-Consultation-Paper-CHESS-Replacement-19-September-2016.pdf>

⁹ <https://www.asx.com.au/documents/asx-news/ASX-Selects-DLT-to-Replace-CHESS-Media-Release-7December2017.pdf>

¹⁰ <https://www.asx.com.au/documents/public-consultations/response-to-chess-replacement-consultation-feedback.pdf>

¹¹ <https://www2.asx.com.au/content/dam/asx/about/media-releases/2019/MediaRelease-ASX-DigitalAsset-and-VMware-join-forces-on-DLT.pdf>

¹² <https://www.asx.com.au/documents/asx-news/asx-consults-on-timing-of-chess-replacement-project.pdf>

¹³ <https://www2.asx.com.au/content/dam/asx/participants/clearing-and-settlement/chess-replacement/stakeholder-communications/chess-replacement-consultation-paper-revised-implementation-timetable.pdf>

¹⁴ <https://www2.asx.com.au/content/dam/asx/about/media-releases/2020/asx-announces-new-scope-and-go-live-date-for-chess-replacement.pdf>

¹⁵ <https://www2.asx.com.au/content/dam/asx/documents/unlinked-docs/chess-replacement-project-update.pdf>

- (d) On 3 August 2022, ASX announced a further delay indicating that the new go-live date for the replacement system was not expected to be before late 2024.¹⁶

46 ASX attributed the delay to its technology vendor, Digital Asset, requiring more time than previously anticipated to meet ASX's scalability and resiliency requirements for the Application. ASX at the time announced it would engage Accenture to provide an independent review of the Application and assess the delivery model for its implementation (the External Review). The External Review's purpose was to bring external expertise to assess the remaining work required to complete delivery of the Application, and identify necessary actions for ASX to communicate a revised timeline to finish the Program.

47 On 17 November 2022, ASX announced a pause to the CHESSE replacement and a derecognition charge of capitalised software of \$245—255 million (pre-tax).¹⁷ ASX also published the External Review¹⁸ which concluded:

- (a) there are complexities in the solution design that contribute to challenges in achieving the necessary supportability, scalability and stability for clearing and settlement;
- (b) there are deficiencies in the current delivery model and execution plan, and there is misalignment of expectations between ASX and Digital Asset; and
- (c) core program delivery capabilities lack maturity and there are significant gaps in testing, quality management, and overall program management.

48 The External Review made recommendations across a number of focus areas, including ways of working, software delivery, quality engineering efficiency and solution design.

49 ASX is currently assessing solution design options for the CHESSE replacement and their potential impacts. ASX must carefully evaluate and select the most appropriate and timely way forward to replace CHESSE.

¹⁶ <https://www2.asx.com.au/content/dam/asx/markets/clearing-and-settlement-services/29-03-august-chess-replacement-schedule-delay-independent-review.pdf>

¹⁷ <https://www2.asx.com.au/content/dam/asx/about/media-releases/2022/60-17-november-2022-CHESSE-Replacement-ASX-reassessing-financial-derecognition.pdf>

¹⁸ <https://www2.asx.com.au/content/dam/asx/markets/clearing-and-settlement-services/asx-chess-replacement-application-delivery-review-2022.pdf>

Industry Impact and Engagement

- 50 Industry has to date mobilised significant resources for the CHES replacement and will need to continue to invest and commit resources until an alternate solution is rolled out. The Stockbrokers and Investment Advisers Association (SIAA), in its appearance at the Parliamentary Joint Committee on Corporations and Financial Services on 23 February 2023 detailed that a third of its members, who are clearing and settlement participants, reported a total direct spend of approximately \$69 million. Of these members, some have spent more than \$10 million, others a few hundred thousand. Vendors and clearing and settlement participants who have their own proprietary systems have both spent large sums readying for CHES replacement. Vendors however may not yet have passed those development costs on to their clients. There has also been an opportunity cost to industry with resources diverted from innovation and other projects to progress the previous CHES replacement application solution.
- 51 Industry has incurred significant cost to date on the CHES Replacement Project and will need to continue to invest and commit resources until an alternate solution is rolled out. At the time of ASX's announcement to pause the replacement project, the regulators stated an expectation that any write-down of work and investment capitalised by ASX on the CHES replacement be borne fully by ASX Limited. On 17 November 2022, ASX publicly confirmed that the CHES replacement capitalised software would be derecognised, resulting in a derecognition charge of \$245—255 million (pre-tax) in ASX's 1H23 results.
- 52 It is ASIC's view that industry needs to have confidence in, and certainty on, the way forward. That requires a delivery plan, including a highly credible, hard go-live date (once the solution design is complete). ASIC expects ASX to actively consult industry throughout this process to ensure there is market confidence in its selected implementation option, delivery plan and timeline. ASIC and RBA will directly engage with industry to make sure their perspectives are given appropriate consideration.
- 53 In response to industry feedback and regulatory expectations, ASX has established an industry forum, the ASX CHES replacement Technical Committee, to provide input to and receive status reporting on the path forward for the project. The Technical Committee has been meeting on a monthly basis since February 2023 with the Regulators attending as observers. The charter and role of the Technical Committee is published on ASX's website.¹⁹

¹⁹ <https://www2.asx.com.au/markets/clearing-and-settlement-services/chess-replacement/stakeholder-engagement/chess-replacement-technical-committee>

- 54 On 16 February 2023, during its half-yearly results, ASX announced the CHES Replacement Partnership Program. According to ASX, the purpose of the Partnership Project is to establish a framework to provide a financial contribution toward stakeholder participation with respect to the successful progress and completion of the CHES Replacement Project. This includes any technological and other development activities necessary to successfully interface and interoperate with the CHES replacement solution that ASX is developing. The Partnership Program totals \$70 million and consists of two components:
- (a) Participant Rebate Pool of \$15 million, from which amounts will automatically be paid to clearing and settlement (C&S) participants, distributed proportionately based on C&S fees paid to ASX by those participants during the period of 1 January 2023 to 30 June 2023; and
 - (b) Development Incentive Pool of up to \$55 million will be available to program participants that meet the eligibility criteria.²⁰
- 55 On 28 April 2023, ASX released details of proposed eligibility criteria for certain stakeholders to receive an incentive payment as part of the CHES Replacement Partnership Program. ASX has invited feedback on the proposed criteria ahead of making the first development incentive payment under the \$70 million program.²¹
- 56 The replacement of CHES with a contemporary technology platform may create opportunities for new service offerings by new and existing providers of financial, market infrastructure and technology services. Historically, there has also been competitive tensions between the provision of services to issuers by share registries and the ASX Group. The potential contestability of new and existing services will mean there are differing views amongst stakeholders that will need to be considered and addressed by ASX in the context of its regulatory obligations, as it selects and implements the replacement solution. Differing stakeholder views will also highlight and capture tensions arising from different participant business models and differing and potentially conflicting requirements between stakeholder cohorts.

Next steps – ASIC’s role

- 57 Together with the RBA, ASIC is closely monitoring ASX’s compliance with its CS facility licence obligations, including the additional licence conditions imposed in November 2021—see [Media Release \(21-313MR\)](#)

²⁰ <https://www2.asx.com.au/content/dam/asx/about/media-releases/2023/asx-half-year-results-presentation-and-speaking-notes-february-2023.pdf>

²¹ <https://www2.asx.com.au/content/dam/asx/about/media-releases/2023/26-28-april-update-ches-replacement-partnership-program.pdf>

ASIC imposes additional licence conditions on ASX and issues expectations to improve market resilience (24 November 2021). ASIC will take further regulatory action if required and will continue to monitor ASX's engagement with industry as it progresses to a decision on the solution redesign in December 2023.

- 58 The Regulators' immediate focus is to ensure current CHES continues to provide the level of service, reliability and resilience that is required. It is critical that market and service continuity be secured. The Regulators expect ASX to maintain and support current CHES to meet on-going resilience, reliability, integrity, and security requirements. The current CHES system must continue to reliably service the market.
- 59 The audited special reports will assist ASIC in its assessment of whether any further regulatory action is required. For more information on these special reports, see paragraphs 35–38.
- 60 ASIC's regulatory priorities are to ensure:
- (a) the adequate functional development, support and maintenance of CHES;
 - (b) that the CHES replacement will meet all functional and non-functional requirements and will enable new functional developments without undue risk and impact to participants in future;
 - (c) that ASX Limited, ASX Clear and ASX Settlement take all necessary steps to address the gaps and deficiencies identified in the External Review and, in addition, to identify and address any other gaps in governance, management and capabilities that may not have been identified in the External Review due to time constraints or limited by their scope of work;
 - (d) that ASX Limited, ASX Clear and ASX Settlement have complied with all relevant licence conditions and their legal obligations more generally.

C Proposed Regulatory Reform

Key points

On 14 December 2022, the Treasurer announced that the Government will act on the Council of Financial Regulator's recommendations and implement two reform packages to facilitate competitive outcomes in CS services and improve Australia's Financial Market Infrastructure regulatory regime. These reforms will provide much needed powers to ensure ASX's compliance with the Regulators' expectations.

Public consultation on the exposure draft legislation to introduce the Competition in Clearing and Settlement (CiCS) reforms closed on 20 April 2023. These reforms will provide ASIC with powers to implement and enforce requirements for a monopoly provider of CS services to operate in a way that achieves competitive outcomes and to ensure safe and effective competition in clearing and/or settlement should a competitor emerge. It also provides the ACCC with the power to conduct binding arbitration to resolve disputes regarding access to clearing and settlement services.

ASIC will work with the Government to implement these reforms, including the development of rules and regulatory guidance to support their considered and appropriate use.

Financial Market Infrastructure (FMI) Regulatory Reforms

- 61 The FMI regulatory reforms package is a significant piece of regulatory reform. Financial market infrastructures (FMIs) enable, facilitate and support trading in Australia's financial markets. They include CS facilities, market operators, benchmark administrators and trade repositories, and are integral to the smooth and effective functioning of the Australian financial system.
- 62 The reforms seek to address deficiencies in the current FMI regulatory regime and ensure ASIC and the RBA (the Regulators) have appropriate powers to pre-emptively identify and manage risks, and to intervene to manage a crisis at a CS facility. The FMI regulatory reforms have been subject to extensive public consultation by the CFR resulting in the 2020 Advice to Government.²² The CFR's recommendations can be grouped into three categories:
- (a) introducing a crisis management regime for licensed CS facilities.

²² <https://www.cfr.gov.au/publications/consultations/2021/financial-market-infrastructure-regulatory-reforms-response-to-consultation/pdf/advice-to-government.pdf>

- (b) redistributing existing powers and decision-making authority between the Regulators and the Minister to reflect their respective responsibilities.
 - (c) strengthening the Regulators' supervision and enforcement powers.
- 63 The first recommendation relates to the introduction of a crisis management regime for clearing and settlement facilities. A crisis management regime would give a resolution authority the tools to take action in respect of a distressed clearing and settlement facility and to support the continuity of the facility's critical market functions. These proposals broadly implement the international standards for resolution regimes for financial institutions adopted by the Financial Stability Board (FSB). Most major economies have put in place, or are putting in place, similar powers for regulators to intervene in systemically important failing institutions. These proposals have also considered the crisis management powers available to the Australian Prudential Regulation Authority.
- 64 The second group of proposed reforms would redistribute existing regulatory powers and decision-making authority between the Regulators and the Minister. Currently, the Minister has powers that more appropriately sit with the Regulators, while ASIC has powers that more appropriately sit with the RBA. Formally redistributing these powers will better distinguish the Regulators' operational responsibilities from the strategic role of Government and align the Regulators' powers with their respective mandates.
- 65 The final group of proposed reforms would strengthen the Regulators' supervisory powers, including information-gathering powers, and broaden the range of enforcement tools they have available. This will give the Regulators significantly more capacity to monitor the ongoing conduct of FMIs, identify risks as they emerge, and take appropriate action to prevent those risks escalating.

Competition in Clearing and Settlement (CiCS) reforms

- 66 The 2015 review of competition in clearing cash equities by the CFR recommended reforms that would allow competition in clearing and settlement (CiCS).²³
- 67 In March 2016, the Treasurer released CFR's advice to Government,²⁴ accepted CFR's recommendations and endorsed a policy stance of

²³ <https://treasury.gov.au/consultation/review-of-competition-in-clearing-australian-cash-equities>

²⁴ <https://ministers.treasury.gov.au/ministers/scott-morrison-2015/media-releases/turnbull-government-open-competition-share-clearance>

openness to competition in clearing and settlement for cash equities. This included implementing legislative changes to:

- (a) allow ASIC to impose requirements on ASX's cash equity CS facilities, including rule-making powers for ASIC in respect of CS facilities; and
- (b) grant the ACCC an arbitration power to provide for recourse in disputes about the terms of access to ASX's cash equity CS services.

68 On 23 March 2023 released exposure draft legislation amending the Act, the *Competition and Consumer Act 2010* and the *ASIC Act 2001* to implement the CiCS reforms.²⁵ Public consultation on the exposure draft legislation closed on 20 April 2023.

69 The exposure draft legislation provides ASIC with powers to implement and enforce requirements for a monopoly provider of CS services to operate in a way that achieves competitive outcomes, and ensure safe and effective competition in clearing and/or settlement should a competitor emerge. It also provides the ACCC with the power to conduct binding arbitration to resolve disputes regarding access to CS services.

70 ASIC is ready to work with Government to implement these reforms as set out in the exposure draft legislation and to use its new powers to facilitate competitive outcomes in the absence and presence of competition in clearing and settlement services including in relation to current CHESS and the CHESS replacement.

²⁵ <https://treasury.gov.au/consultation/c2023-367748>

Key terms

| Term | Meaning in this document |
|--|---|
| ACCC | Australian Competition and Consumer Commission |
| Act | <i>Corporations Act 2001</i> (Cth) |
| ASX Clear | ASX Clear Pty Ltd |
| ASX Settlement | ASX Settlement Pty Ltd |
| CHESS | Clearing House Electronic Subregister System |
| CHESS replacement, or CHESS replacement system | The new system that will replace the current CHESS, and which is to be delivered or implemented as part of the CHESS Replacement Project |
| CHESS Replacement Project | The project established by ASX to replace CHESS with the CHESS replacement system. It is also known as the CHESS Replacement Project. |
| CHESS user | A CHESS user is defined by ASX as any organisation that connects directly to CHESS. This includes market operators, clearing and settlement participants, product issuer settlement participants, share registries and payment providers. |
| CFR | Council of Financial Regulators |
| External Review | The external review undertaken by Accenture into certain aspects of the CHESS Replacement Project application delivery between September and November 2022 |
| FMI | Financial market infrastructure |
| FSS | Financial Stability Standards as set by the RBA |
| RBA | Reserve Bank of Australia |
| Regulators | ASIC and the RBA |
| SIAA | Stockbrokers and Investment Advisers Association |
| Technical Committee | ASX CHESS Replacement Technical Committee |