

**ANSWERS OF DIGITAL ASSET TO ADDITIONAL QUESTIONS ON NOTICE POSED BY THE
PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES
IN RESPECT OF THE ASX CHESS REPLACEMENT PROJECT**

Dear Committee Members,

Digital Asset appreciates the opportunity to respond in writing to the additional questions posed by the Parliamentary Joint Committee on Corporations and Financial Services (**Committee**) by letter dated 11 July 2023 (**Further Questions**), regarding the ASX CHESS Replacement Project (the **Transformation Project**).

The Further Questions seek the view of Digital Asset in respect of a number of recommendations made in submissions to the Committee's inquiry into the Transformation Project. The specific recommendations are as follows:

Recommendations made in the submission of the Financial Services Council (**FSC**) dated 4 May 2023:

1. *The FSC recommends the ASX staggered open should be removed, or alternatively that an interim measure be implemented which would move ETFs to the end of the ASX market open framework.*
2. *The FSC recommends that the ASX give consideration to later settlement matching or having an efficient mechanism to adjust settlement when the value is not finalised in time for matching to align with the USA moving to T+1 Settlement next year.*
3. *The FSC recommends that the provision of investor email addresses for new and existing clients via CHESS be mandated, requiring brokers to pass these to CHESS, to facilitate electronic communication with investors.*

Recommendation made in the submission of FinClear Holdings Ltd (**FinClear**) dated 3 March 2023:

1. *The Council of Financial Regulators should step in and redesign the approach here (instead of ASX) given the changes that we have seen in the industry as well as in the technology and solution space. This should include taking steps to facilitate innovation (through sandbox or other exemption solutions).*

Recommendation made in the submission of Cboe Australia Pty Ltd (**Cboe**) dated 11 May 2023:

1. *Support for the passage of the Financial Sector Reform (Competition in Clearing and Settlement) Bill 2023;*

2. *A clear recommendation for regulators to use their powers to address the extreme vertical integration of the ASX Group and the resulting conflicts of interest, which is the root cause of the failures around the provision of clearing and settlement services in Australia; and*

3. *A clear recommendation for regulators to promote and enable competition in the provision of clearing and settlement services.*

1. Response of Digital Asset to the recommendations made in submissions of the FSC, FinClear and Cboe

The recommendations made by the FSC, FinClear and Cboe set out a range of specific regulatory or legislative proposals that address broader market structure and governance issues outside the scope of Digital Asset's involvement in the Transformation Project. Accordingly, Digital Asset is not in a position to comment meaningfully on those specific recommendations.

2. Response of Digital Asset to themes arising from the submissions of the FSC, FinClear and Cboe

That said, in order to assist the Committee as far as it feels competent to do so, Digital Asset has considered the extent to which we can provide comments on certain generalised themes emerging in recommendations of the FSC, FinClear and Cboe. Our further comments in this regard are set out below.

a) the redesign process

Given where the Transformation Project stands today, we understand the need and desire to restore confidence to the Australian market in the redesign process. This is particularly true in light of the long-term ramifications that choice of technology will have to the market. Technological innovation is critical to maintaining the competitiveness of financial markets. Through our many projects across the globe, we have seen this firsthand. Accordingly, we wanted to comment in general terms on the substance of the various recommendations to which our attention has been drawn, including specifically, the submission by FinClear regarding redesign of the CHES system in the context of the Transformation Project.

Digital Asset has devoted significant resources to the Transformation Project since 2016, developing and designing a replacement for CHES that is built on our distributed ledger technology. Throughout the development process, and despite the many challenges we faced, we truly believed that just like in late 1980s and early 1990s, when what became CHES was first proposed, we were building an innovative and groundbreaking clearing and settlement solution that would help the Australian market retain its global competitiveness. We still believe that today. Prior to the project being paused, and prior to the addition of many late requirements by ASX, more than 90% of the overall scope of the project had been shipped to ASX for testing. This achievement represents tens of thousands of hours of work, during which the Digital Asset engineering team gained a unique and thorough understanding of the intricacies of the Australian clearing and settlement process, and applied that knowledge to the system we built.

As we noted in our submission to the Committee on 26 May 2023:

“Digital Asset remains committed to the Transformation Project. Given that Digital Asset’s technology is successfully being used to operate critical financial infrastructure in other markets, we genuinely believe that a new CHES system based on DLT that leverages the work already completed by Digital Asset can meet all of the requirements for a safe, stable and scalable clearing and settlement system necessary to position the Australian market as a premier destination well into the future.”

Given the unique understanding of CHES that we have gained over the last seven years, Digital Asset would be honoured to work on the redesign. In any case, we want to ensure that—no matter who builds it—Australia gets a CHES replacement that is robust against future innovation, that will service the Australian market’s growing needs well into the future and that is delivered within a reasonable timeframe. For this reason, we genuinely believe that the Australian market would benefit from use of the work already completed, and urge all stakeholders to encourage the ASX to consider options that will allow the progress already made not to be wasted. The work completed to date was specifically and intentionally designed to handle the unique complexities of the Australian clearing and settlement process and many market participants had begun testing against it. Discarding this work would cause further unacceptable and unnecessary delays in deployment of a new system.

We also truly believe that any CHES replacement should be built using distributed ledger technology. Major market participants across the globe are modernizing their financial infrastructure using this technology. To understand why, it is important to remember that ledgers are at the heart of the financial system, and that records of which parties own what assets are the financial system’s DNA. Unfortunately, ledgers today—even when digital—simply mimic the siloed structures of old, paper-based record-keeping systems. With siloed ledgers, transactions can only settle through extremely inefficient messaging and reconciliation systems, creating enormous frictions in the financial system.

However, with distributed ledger technology, ledgers across parties can be synchronized, eliminating the need for messaging and reconciliation. By natively representing financial assets digitally using distributed ledger technology, these financial assets can be “tokenized”, enabling movement of these assets without the frictions experienced using traditional, siloed ledgers. As a key U.S. regulator recently stated, “*tokenization of real-world assets could save 35 to 65 percent across the settlement value chain, including, for instance, cost savings of up to [US]\$5 billion for equity-post trading.*”¹

Australia was extremely prescient to see the benefits of this technology in 2016. To abandon it now, when many major exchanges are looking to implement solutions based on it and when many regulators in advanced economies see its transformational benefits, would be a shame. More than that, it would be a decision that we believe will come back to haunt the

¹ <https://www.occ.gov/news-issuances/speeches/2023/pub-speech-2023-64.pdf>

Australian market when the shortcomings of the existing CHES system or any supposed “out-of-the-box” solution are laid bare in the coming years. Whatever form the redesign process may take, we believe it is critical to take these technological considerations into account and have a transparent process that restores market confidence.

b) the regulatory and legislative framework

Digital Asset supports regulatory frameworks that enable innovation, promote competition and reduce market risk and inefficiency. In our view, countries with regulatory regimes that enable responsible innovation and that promote competition will no doubt take a leading role in tomorrow’s global economy because technological innovation is critical to financial competitiveness. And the market discipline imposed by competitive market structures is critical to ensuring financial innovation.

While we are not in a position to comment on the specific recommendations made by the FSC, FinClear or Cboe, our involvement in matters concerning the Committee’s inquiry into the Transformation Project leaves us in no doubt that Australia’s regulators and legislators will continue to correctly determine what is best for the Australian market. We are further confident that Digital Asset’s technology will be able to allow for the design of solutions that bring innovation to the Australian market within whatever regulatory framework Australia adopts.