



3rd March 2023

Submission to the Parliamentary Joint Committee on Corporations and Financial Services

RE: ASX and CHES - Oversight of ASIC, the Takeovers Panel and the Corporations Legislation

Committee Secretary

Parliamentary Joint Committee on Corporations and Financial Services

PO Box 6100

Parliament House

Canberra ACT 2600

Dear Committee Members

Thank you for the opportunity to appear and present to the Parliamentary Joint Committee on Corporations and Financial Services on the ongoing and significant issues with ASX Limited's management of the replacement of the Clearing House Electronic Subregister System (CHES).

As you would have seen in the proceedings before the PJC, there is a strong view across the industry – from stockbrokers to share registries, to other market participants and stakeholders that the CHES replacement project has been severely compromised, in a large part, through the ASX's ingrained lack of transparency and engagement with the industry that the ASX is there to support. There is also a clear view that the ASX has irreconcilable conflicts of interest in this project, that it does not have the capability to execute the replacement of CHES and can no longer be trusted, or relied upon, to deliver the replacement. There is a real sense that recovering this trust will be significantly challenging for ASX in the near, and even medium, term.

We believe there are three options open to regulators at this critical junction:

1. Continuing with the current process, understanding CHES as it stands is critical infrastructure and must be upgraded to more contemporary architecture to continue servicing the industry for many years and not just at the point of delivery, whenever that might be. Concurrent to this there is an opportunity and a need for regulatory settings to be reformed to promote greater competition. Whilst this approach would (if executed well) at least ensure continued functionality, regrettably it would not support or deliver innovation.
2. Conclude that the ASX, both from a competency and competition perspective, is unable to deliver and maintain the current capability and must transition to a different operating model where industry participants jointly own and operate this capability as a utility to service all. FinClear stands ready in its capacity as a trusted counterpart across the industry to assist in such a process.
3. Adjust current regulatory settings to promote innovation and competition via alternate capabilities and encourage direct participation from leading alternate providers with a view to diversifying risk away from a single monopolistic provider. This approach is already being successfully implemented by many international jurisdictions.

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We see (3) as an option that naturally diversifies risk away from a single point of concentration and is a way for regulators to ensure the Australian market remains competitive, ensuring there is continued inward investment and a reduction of charges and fees that impact all Australians (through their super funds).

FinClear has been working on distributed ledger technology similar to what the CHES replacement needs. We appreciate that this is at a different scale to the system ASX has sought to introduce. Nonetheless, we consider it capable of being scaled. Our product, FCX, is an initiative for private unlisted markets - supporting unlisted companies and start-ups with their capital raising as well as digitising their cap-table. The exchange capability, if approved by ASIC, will also allow investors in unlisted companies to trade private shares in a safe way, at faster speeds than a trade on the ASX, and for those transactions to be settled atomically.

FCX and its capability is a global first and demonstrates Australia continues to innovate and lead global financial markets. The technology, via distributed ledger and smart contract capability, demonstrates that heritage infrastructure currently used to underpin CHES will overtime be displaced. See article here in the Financial Review 24th November 2022 ([FinClear shows ASX its technology can create a new settlement system](#)).

FCX and its underlying technology is the solution that many international banks, corporates and exchange/clearing houses are already implementing. It is exactly the kind of product Australia should be implementing in a discrete, or 'sandbox' environment, to show the markets there are different, functioning, highly effective capabilities already available. FCX in its current form would already qualify for the pilot programs about to be initiated by the EU and UK regulators.

FCX is a system that will support atomic (real time) settlement based on distributed ledger technology where shares and cash are represented as tokens and enables title of both to pass at the instant of the trade.

In the regulation of *markets*, ASIC has a two tiered approach which enables it to take a proportionate approach to the obligations it puts on market operators, as compared to, say the ASX. However, there is no such proportionate approach to clearing and settlement, where ASX maintains a monopoly. We should have a system which supports a sensible and proportionate approach to new platforms which provide for atomic settlement. We should have legislation which recognises the electronic and atomic transfer of legal title to securities - but we don't, because the Corporations Regulations state that it is only ASX Settlement that can transfer title via electronic messages. This is outdated and stifles investment in both private and public market infrastructure that could deliver electronic and atomic settlement. This must be reformed.

FCX currently has a licence application before ASIC to operate a market, to enable investors of private unlisted companies to trade shares. Our licence application also contemplates that our platform will provide atomic (instant) settlement of these trades. We would hope to find sensible and proportionate

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ways to facilitate this type of innovation, without the need for FCX to *separately* be approved as a clearing and settlement facility. We are satisfied that our solution provides a safe, reliable and robust mechanism for the trades to be settled atomically – however if we, and others like us, also need to be regulated as clearing and settlement facilities, innovation in this area will be stifled, if not eliminated.

A measured proportionate response (such as an exemption from the CS facility regime) would enable and encourage alternate capabilities via a discrete/ring fenced implementation that can over time be more broadly implemented if the market and regulators believe it is useful.

In parallel to encouraging this innovation it is FinClear's view that the PJC Committee needs to help ensure the following outcomes:

- A. A high level group involving all of industry to design and develop the CHES replacement solution (not just oversight the ASX process)
- B. A process to drive longer term regulatory reform that either encourages genuine competition or enables innovation to be deployed in adjacent capabilities (per above).

As I outlined in my appearance at the PJC, there are a range of issues that make clear the case for change and underscore the importance of the PJC's inquiry:

1. The deficiencies, previously identified by the Council of Financial Regulators, in the current regulatory framework for financial market infrastructure – including the lack of competition in clearing and settlement for equities – continue to exist and are beginning to have real consequences with the bungled replacement of the CHES system
2. Replacing CHES is urgent because the technology that underpins it is becoming obsolete along with the resources (people) that are required for ongoing maintenance and development of the technology.
3. ASX cannot be relied upon to fix what is critical infrastructure. It would be a mistake to leave it to ASX to design a solution. ASX remains in a highly conflicted position and its competence to deliver such a complex project is highly questionable. At best it will lead to a piecemeal of disparate technologies, entrenching monopoly, or at worst, to another aborted project.
4. Technology is moving fast: Distributed-ledger technologies are becoming more commonplace globally: Hong Kong, Japan, and the NASDAQ in the US all have some versions of this. Here in Australia, FCX (operated by FinClear) is aiming to be Australia's first centralised platform for private company securities, to provide private investors with digital access to unlisted assets on a DLT-based registry.
5. Every Australian is impacted because not getting this right impacts investment flow into Australia and more importantly makes equities traded on behalf of superannuation less efficient and with more costs - i.e. the fees and charges and deficiencies do have an impact on everyday Australians.

Based on these findings, we would reinforce our call for the recommendations arising from the PJC's inquiry to include:

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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).
2. The legislation foreshadowed by the Treasurer in the media release dated 14 December 2022 should be advanced to update regulatory settings to deliver genuine competition for new entrants to enter Australia, not just increased powers to regulators to monitor an existing monopoly.

Having an inefficient and ineffective clearing and settlement service in Australia impacts everything through higher costs and fees - especially through the superannuation funds.

Thank you again for the opportunity to appear before the PJC. Our company and the industry will continue to engage with the regulators on this issue and we would welcome the opportunity for an ongoing dialogue with the Parliament to ensure that one lost decade does not become two.

Kind regards

David Ferrall
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FinClear

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