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Via Electronic Mail

Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

E-mail: fsb@bis.org

Re: Comments on the Financial Stability Board's Consultative Document: Cross-border recognition of resolution action (29 September 2014)

Ladies and Gentlemen:

CLS Bank International ("CLS") welcomes the opportunity to comment on the Financial Stability Board's (the "FSB") consultative document on cross-border recognition of resolution actions (the "Consultative Document"). As you are aware, CLS is the operator of a systemically important financial market infrastructure (an "FMI") that is the world's largest multicurrency cash settlement system for FX and provides a payment-versus-payment settlement service in 17 currencies (the "CLS System"). CLS operates the CLS System via funding through its accounts with the central banks associated with the currencies it settles, and CLS and its affiliates maintain a physical presence in New York, New Jersey, London, Tokyo and Hong Kong. Over the years, CLS has grown consistently with the FX market and, today, CLS serves over 60 Settlement Members, all of which are financial institutions subject to prudential regulation and supervision, and over 10,000 third-party users.

As an Edge Act corporation, CLS is regulated and supervised by the Federal Reserve under a programme of ongoing supervision, combining full-scope and targeted on-site examinations with a variety of off-site monitoring activities. Additionally, the central banks whose currencies are settled in CLS have established the *CLS Oversight Committee*,¹ organised and administered by the Federal Reserve, as a mechanism to carry out the central banks' individual responsibilities for promoting the safety and efficiency of payment and settlement systems, and the stability of the financial system. The CLS System is a "designated system" under European Union Directive 98/26/EC (the Settlement Finality Directive), which applies in 7 Eurozone jurisdictions plus Denmark, Sweden and the United Kingdom, and it is also designated in nine other jurisdictions. Additionally, the United States Financial Stability Oversight Council

¹ In addition to the European Central Bank, the CLS Oversight Committee also includes five other Eurosystem central banks, bringing the total to 22 central bank members.

has designated CLS as a systemically important financial market utility.

Comments

CLS considered the questions posed in the Consultative Document from the perspective of an FMI and its comments are therefore focused on (i) cross-border resolution proceedings applicable to FMIs and (ii) as regards resolution measures applicable to other types of financial institutions, the continuity of legal protections applicable to FMIs before, during and after an FMI-participant resolution.

Question 1: Are the elements of cross-border recognition frameworks identified in the report appropriate? What additional elements, if any, should jurisdictions consider including in their legal framework?

As the Consultative Document highlights, the Key Attributes² require jurisdictions to establish transparent and expedited processes that would enable resolution measures taken by a foreign resolution authority to have a cross-border affect. CLS supports this requirement, as well as the proposed elements of cross-border recognition frameworks set forth in the Consultative Document. In particular, CLS supports element three which states that “the ability to refuse the recognition of foreign resolution should generally be limited to [stipulated] cases” because it reinforces that recognition should normally be granted, and should not be contingent upon reciprocity. (Consultative Document, Section 1.2.3).

CLS notes, however, that it is unclear whether the proposed elements are intended to extend to the resolution of an FMI that operates across jurisdictions. CLS recommends separate further analysis and consultation on that topic as the objectives in an FMI resolution, i.e., continuity and timely completion of the FMI’s critical functions,³ differ from those in the resolution of other types of entities. In undertaking such analysis, CLS highlights that in order to ensure uninterrupted service from and market confidence in a cross-border FMI in resolution, it must be clear which type(s) of resolution measures could apply to the FMI in its main jurisdiction, and any resolution measures taken must be given effect automatically pursuant to clear statutory language in all jurisdictions where the FMI has a presence (i.e., affiliate(s), branch(es)) or assets).⁴ Moreover, to maintain the continuity of an FMI’s service in resolution, resolution measures and statutes recognising foreign resolution measures must be crafted with a mind toward protecting the FMI’s service, and should therefore include (i) powers to enforce contractual terms notwithstanding clauses for termination upon resolution,⁵ and (ii) stays to protect the FMI’s assets that are used for its systemically important function, wherever held.⁶

² FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions (15 October 2014).

³ See Key Attributes, II-Annex 1, Part I “Resolution of Financial Market Infrastructures,” Section 1.1 (Objectives).

⁴ CLS supports the approach contained in the UNCITRAL Model Law on Cross-Border Insolvency (the “UNCITRAL Model Law”) discussed in the Consultative Document, which provides for the recognition of a debtor’s “main” jurisdiction’s insolvency proceeding in other jurisdictions where the debtor has a presence, upon application to the local court. See UNCITRAL Model Law, Chapter 3. However, CLS holds funds each day as a conduit for its members to complete funding associated with the settlement of foreign exchange transactions, and believes that in order for its members to maintain confidence that those funds would be used for their intended purpose during CLS’s resolution, automatic and immediate *statutory* protection for its accounts (i.e., not dependent on judicial recognition) would be necessary in each jurisdiction where they are maintained.

⁵ Some FMIs may use vendors, or even other FMIs such as RTGS systems, that are critical to the performance of their service, and therefore such third party’s refusal to provide services would affect the financial community at large. Thus, CLS supports affording resolution authorities the flexibility to ensure the continued performance by third parties under their existing agreements with FMIs, assuming the FMI also continues to perform under such agreements.

⁶ The principle of “no creditor worse off” should apply notwithstanding such stays, but as is explained in footnote 4, protections from creditor actions for an appropriate time period may be necessary to maintain market confidence while the resolution authorities resolve the FMI in an orderly way to prevent systemic disruption.

Additionally, it is important that FSB members, in cooperation with individual FMIs' Crisis Management Groups ("CMGs"), carefully design resolution measures for FMIs to avoid unintended consequences. As the FSB highlights in the Key Attributes, resolution measures should not result in the revocation of licenses, authorisations, recognitions, legal designations or other protections on which FMIs rely.⁷ The continuity of such protections before, during and after a resolution should be definitive, clear and transparent,⁸ and therefore the authorities and CMGs must consider how these protections might be affected by an FMI's resolution in a foreign jurisdiction. FSB members must also be mindful of the potential for unintended consequences resulting from safe harbours from insolvency laws that may exist for certain types of contracts, particularly in the context of the resolution of an FMI that settles or clears transactions. Due to these complexities, resolution measures for FMIs require unique consideration and a special emphasis on certainty and international coordination in order for an FMI in resolution to maintain the confidence of its participants and thereby provide its critical services without disruption.

Question 3: . . . Is the effective cross-border implementation of any other resolution actions sufficiently relevant for the resolvability of firms that the FSB should specifically consider ways of achieving their cross-border enforceability?

CLS agrees with the Key Attributes that "it is necessary that the firm in resolution...can continue to rely on services provided by FMIs...as long as it promptly performs its margin, collateral or settlement obligations", since such access may be critical to the success of the resolution.⁹ Accordingly, CLS believes that institutions that are participants in FMIs, as well as FMIs themselves, should take all necessary and appropriate actions to maximise the likelihood that continued participation will be possible. However, continued participation in a designated system by an entity in resolution should not jeopardise the legal basis of the system (FMIs must comply at all times with "Principle 1: Legal Basis") and it is therefore critical that the application of the fundamental legal protections to designated systems will not be called into question as a result of the resolution. For CLS, or any FMI that relies upon statutory finality protections and/or designations, careful implementation of cross-border resolution measures is therefore particularly important so that these protections are not unintentionally lost or called into question.¹⁰ If there are doubts as to the continuation of such protections, in order to protect the system and its members and to limit the risk of systemic impacts, a designated system may well be forced to exclude the resolving entity from the system.

Like the FSB, CLS is aware that most jurisdictions do not currently have statutory powers to recognise, enforce or give legal effect to foreign resolution proceedings and therefore resolution proceedings commenced with respect to an entity in one jurisdiction can result in legal uncertainty with regard to the entity's offices, subsidiaries, branches or assets in other jurisdictions. (Consultative Document, Section 1.) When undertaking the implementation of cross-border resolution measures, FSB members must be cognisant that FMI participants may access the FMI's services via offices, subsidiaries, or branches outside of such participant's main jurisdiction. If protections are not carefully drafted and effective in each

⁷ Key Attributes, II-Annex 1, Part I, at Section 4.6.

⁸ FMIs must comply at all times (even during resolution) with Principle 1 (Legal Basis) of the Principles for Financial Market Infrastructures, which requires that an FMI have "a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions."

⁹ See Key Attributes, II-Annex 1, Part II "Resolution of FMI Participants."

¹⁰ As the FSB highlighted in the Key Attributes, "[j]urisdictions should ensure that laws and regulations applicable to FMIs should not prevent FMIs from maintaining the participation of a firm in resolution provided that the safe and orderly operation of the FMI is not compromised." Key Attributes, II-Annex 1, Part II, at Section 1.2. Other FSB publications have also underscored the need to consider these types of obstacles in the cross-border context. See Progress and Next Steps Towards Ending "Too-Big-To-Fail" (TBTf), at pages 3-4; see also Thematic Review of Resolution Regimes (11 April 2013), at page 10.

relevant jurisdiction, upon resolution, statutory finality protections for designated systems may terminate for an FMI in a particular jurisdiction, even if the resolution proceedings commenced in the entity's main jurisdiction contemplated the continuation of its business. Such unintended consequences could undermine the goal of a resolution proceeding if the FMI must stop providing services due to the compromise of its legal protections, and should therefore also form part of any CMG's analysis. Additionally, FSB members and CMGs should acknowledge and consider the indirect linkages between FMIs, and the potential adverse impact on other FMIs resulting from the failure of an entity in resolution to continue to participate in an FMI in another jurisdiction. For example, if an entity in resolution cannot participate in an RTGS system in one jurisdiction, this may adversely impact on its ability to participate in an FMI in another jurisdiction. Therefore, it is important for FSB members to comprehensively consider resolution measures and ensure that they are aligned internationally.

Finally, CLS believes that careful drafting and clear and automatic recognition regimes will mitigate, in the near term, many of the issues it has highlighted. However, a long-term coordinated change in law to provide for a resolution regime for cross-border financial institutions and FMIs pursuant to an internationally agreed treaty such as the UNCITRAL Model Law on Cross-Border Insolvency, which contemplates recognition of foreign proceedings and assistance and relief to foreign courts and foreign representatives, should be considered by the international community.

Please do not hesitate to contact us if you have any questions regarding this letter.

Sincerely,

A handwritten signature in black ink, appearing to be 'Alan Marquard', written over a horizontal line.

Alan Marquard
Chief Legal Officer
CLS Group

cc: Dino Kos, Executive Vice President, Head of Global Regulatory Affairs, CLS Bank International
Lauren Alter-Baumann, Managing Director, Legal and Regulatory Strategic Affairs, CLS Bank International
Andrea Gildea, Director, Assistant General Counsel, CLS Bank International