



CLS Bank International

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Financial Stability Board  
[fsb@bis.org](mailto:fsb@bis.org)

Dear Sir/Madam,

We are writing to share our views on the Consultative Document dated July 19, 2011 on the Effective Resolution of Systemically Important Financial Institutions (the "Document") issued by the Financial Stability Board (the "FSB"). Thank you for the opportunity to submit these comments.

## **1. Background**

As the FSB is aware, CLS Bank International ("CLS Bank") is a special purpose corporation that was established to reduce settlement risk in the foreign exchange market. CLS Bank was created as a result of the collaborative efforts of central banks and financial institutions headquartered in several sovereign jurisdictions. It is organized under the laws of the United States of America, but the Rules of the CLS System are governed by English law. The CLS System was designated in the United Kingdom in 2002 by the Bank of England for the purposes of the EU Settlement Finality Directive 98/26/EC (the "SFD"). The CLS System has also been designated or recognised for the purposes of the comparable finality legislation in many other jurisdictions.

The CLS System went live in September 2002 and as mentioned above was the result of the collaborative efforts of FX market participants and various central banks, including the Board of Governors of the Federal Reserve System in the United States (the "Federal Reserve"), the European Central Bank (the "ECB") and the Bank of England, in response to regulatory concerns regarding FX settlement potentially giving rise to systemic risk. Over the years CLS Bank has grown consistently with the FX market, and now settles FX transactions in 17 currencies representing an estimated 94% of the daily value of FX swaps and forwards traded globally, with over 60 members and 12,000 third-party users. While CLS Bank is owned by many of the largest participants in the FX market, it continues to acknowledge and further the dual public-private purpose that gave rise to its creation.



As an Edge corporation chartered by the Federal Reserve, CLS Bank is regulated and supervised by the Federal Reserve as a limited purpose bank. This entails full-scope and targeted on-site examinations, and various off-site monitoring activities, on an ongoing basis. In addition, representatives of the central bank for each currency (including the ECB and central banks of those Eurozone jurisdictions where CLS Bank has members), participate in the CLS Oversight Committee to promote the safety, efficiency, and stability of their respective payment systems. The CLS Oversight Committee meets regularly and operates in accordance with the Protocol for Cooperative Oversight of CLS. The Protocol was adopted to avoid duplication of effort by the central banks, foster consistent, transparent communications between the central banks and CLS Bank, and enhance transparency regarding applicable regulatory policies in the CLS Bank jurisdictions.

## **2. CLS Bank's review and position**

In reviewing the Document and providing these comments, CLS Bank has focussed upon its position as a financial market infrastructure (an "FMI") and the way in which other systemically important financial institutions ("SIFIs") might interact with it if any such SIFI were to become subject to a resolution regime.

CLS Bank endorses the broad approach that the FSB is taking with respect to recovery and resolution plans. We support the prompt taking of resolution steps and the desire to preserve SIFIs to the extent their businesses are robust and can be maintained. There must be consistency in the legal approaches which the authorities take around the world if FMIs are to be able to meet the authorities' requirement that SIFIs have uninterrupted access to FMI's systems. CLS Bank, in its role as the operator of a system designed to mitigate settlement risk in the global FX market, therefore wishes to draw the FSB's attention to certain issues highlighted below, including those where actions taken as part of resolution plans could jeopardize the market as a whole or prejudice other players within the market and result in unintended consequences for FMIs and SIFIs.

## **3. Cross-border cooperation**

In response to Question 9<sup>1</sup>, based upon its own analysis of cross-border issues in jurisdictions where CLS Bank either settles a currency or has a member, CLS Bank strongly supports adoption of appropriate international treaties (having the force of law in the jurisdictions of the countries subscribing thereto) requiring cooperation and coordination of reorganization or liquidation proceedings commenced against a head office and global branches of member financial institutions. The ongoing legal diligence conducted by CLS Bank with respect to finality of settlement demonstrates that greater coordination and cooperation between authorities is essential. Most CLS Bank members operate through offices around the world and the means by which an effective resolution is commenced in one jurisdiction could be jeopardized by the opening and conduct of insolvency proceedings by a different authority in respect of offices of the same entity operating in another jurisdiction. For example:

- insolvency proceedings commenced with respect to offices in one jurisdiction could result in the closure of key offices, or discontinuance of essential services or business operations, in the jurisdiction where those proceedings are opened, potentially undermining a global resolution plan being implemented in the jurisdiction of an institution's head office; and

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<sup>1</sup> Question 9: How should a statutory duty to cooperate with home and host authorities be framed? What criteria should be relevant to the duty to cooperate?



- insolvency proceedings commenced in any jurisdiction could prevent FMI's like CLS Bank from continuing to provide their services to an institution in other jurisdictions globally; an insolvency proceeding in a third country could result in the cessation of finality protections in that third country, which would have consequences for the entity itself and for designated systems in which it participates. For example, the local payment system in that third country may suspend the entity from participating in that system. As a result, the entity might not be able to fund its obligations in certain currencies on a timely basis, if at all. In addition, statutory protections for finality of settlement, which are critically important to the operation of the CLS System, may cease to be available not only in a jurisdiction in which an insolvency proceeding has been opened, but in other jurisdictions around the world, even if the head or home office or other major parts of the entity are being satisfactorily resolved.

Some of these issues can be addressed by changes in the relevant laws in specific jurisdictions. However, other issues (such as the risk that actions in one country could undermine a global strategy to restructure or resolve an institution, as described in the first bullet point above) require international agreement on cooperative supervisory action through a coordinated international change in law. CLS Bank encourages the FSB to promote an extension of the principles of the kind that underlie the UNCITRAL Model Law on Cross-Border Insolvency so that they would apply also to the resolution of financial institutions (see page 13 of the Document). We appreciate that such treaties can take many years to finalize and implement, but the high level of consensus between authorities and regulatory support from the FSB should expedite this process.

As an interim step that can be taken promptly, pending the adoption of a UNCITRAL model law for financial institutions, CLS Bank strongly encourages and supports negotiation and adoption of a multi-lateral agreement, or a series of bilateral agreements, between the relevant authorities of jurisdictions in which they would agree on what effect the commencement of a resolution in respect of a SIFI in a particular jurisdiction should have, including when it would be recognized and how it would be given effect in each of the other jurisdictions which are party to the agreement.

The Document anticipates that, even under agreements or treaties, individual jurisdictions would retain some flexibility to take their own actions (see page 14 of the Document), although it acknowledges that this flexibility is not available to the EU Member States which are bound by the EU Winding Up and Reorganisation Directives. Under these Directives, the only insolvency proceedings that may be opened in respect of a credit institution or an insurance company are those which are available in its home Member State, and each other Member State must recognize and enforce those insolvency proceedings. CLS Bank questions whether the flexibility of independent action is essential among all jurisdictions when it



was not considered to be so by the EU Member States. While there may be some utility in preserving a degree of national flexibility, such flexibility could also lead to jurisdictions pursuing their own interests in a way which would defeat the purpose of the Document.

Nevertheless, we recognize that there are differing views in this area and, where flexibility of a jurisdiction to act unilaterally is preserved, CLS Bank believes that any relevant cooperation agreement or agreements should, at a minimum, require that any authority taking unilateral action outside the framework of a globally coordinated proceeding should notify FMIs immediately prior to, or as soon as practicable after, such action is taken. This would enable the FMIs themselves to take the appropriate steps to preserve the stability of their systems. Unless such immediate notice is given, the FMIs may allow continued participation during a period in which finality or netting globally has been jeopardized by the taking of the relevant action, and FMIs have no practicable way to monitor or otherwise learn of unilateral insolvency actions of authorities in every jurisdiction quickly enough to act.

The efficacy of cooperation agreements depends upon all relevant persons being party to them. Under legal regimes in which only national authorities (governments, central banks, financial regulators etc) can initiate insolvency proceedings in respect of SIFIs, agreement among such authorities should be sufficient. In other jurisdictions, it may be possible for creditors of a troubled SIFI to take local, independent action which might conflict with the cooperation agreements or otherwise cause the problems which the Document is seeking to mitigate. In any such cases, as a further stage in the development of international cooperation, the agreements should not only bind the authorities which are party to it, but a means to override any provisions of the laws of those jurisdictions which are contrary to the agreement, likely requiring the introduction of supporting legislation.

#### **4. Temporary stay on early termination rights**

With reference to Question 30<sup>2</sup> and to Annex 8 to the Document, while it supports the attempt by the FSB to allow the continuation of a SIFI's outstanding positions, FMIs must also keep in mind their primary obligation to preserve the robustness of their systems. We therefore strongly recommend that the temporary stay should not apply to FMIs. FMIs should work with the authorities to reach a common understanding regarding goals and priorities, and to review in what circumstances suspension of a SIFI is likely. CLS Bank supports the continued participation of a SIFI member, provided that continued participation by the SIFI does not expose CLS Bank to systemic risks or jeopardize its compliance with the Core Principles for Systemically Important Payment Systems. Accordingly, FMIs must be able to operate within the scope of their rules, free of any stay.

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<sup>2</sup> Question 30: What should be the scope of the temporary stay? Should it apply to all counterparties or should certain counterparties, e.g., Central Counterparties ("CCPs") and FMIs, be exempted?

## **5. Consultation with FMIs**

With reference to Question 1<sup>3</sup> and Question 16<sup>4</sup> (and to paragraph 10.1 of Annex 1, paragraph 4.3(iii) of Annex 5 and paragraph 4 of Annex 6 to the Document), CLS Bank encourages the authorities that form Crisis Management Groups in respect of global SIFIs (“G-SIFIs”) to consult each relevant FMI on how resolution could have an impact upon the applicable G-SIFI’s membership of that FMI and how to maximize the likelihood of uninterrupted access to FMIs. In each case, the relevant FMI will be the institution best-placed to identify the steps required. In practice, the same principles are likely to apply to all of the members of an FMI with respect to a jurisdiction, so it will not be necessary for the FMI to be consulted on each institution-specific cooperation agreement to which authorities in that jurisdiction are party. The mandates of resolution authorities referred to on page 14 of the Document should therefore be framed so that those authorities also have to duly consider the potential impact of their resolution actions on the global markets and financial infrastructure.

With reference to paragraph 11.3 of Annex 1 to the Document, for the same reason we also encourage G-SIFIs to consult FMIs in relation to their recovery plans.

CLS Bank has done considerable work in identifying those areas where typical recovery or resolution tools may not be sufficient to transfer membership of the FMI; in particular, certain additional administrative and legal steps will need to be taken. Moreover, the taking of other steps suggested in paragraph 4.1 of Annex 6 to the Document, such as the provision of collateral by the SIFI, may not be adequate to address a fundamental defect such as the loss of finality protection.

## **6. Notice to FMIs**

With reference to Question 1 and to paragraph 7.5 of Annex 1 to the Document, the practical and legal consequences for FMIs of any delay in the disclosure of resolution actions must be taken into account. Authorities should note that certain settlement finality protections (and in some cases netting protections as well) may end after a specific period of time even if the FMI is not aware of the occurrence of the relevant insolvency proceedings – this would be the case even if the FMI could not have been aware because the relevant action had not been publicly disclosed.<sup>5</sup>

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<sup>3</sup> Question 1: Comment is invited on whether Annex 1: Key Attributes of Effective Resolution Regimes, appropriately covers the attributes that all jurisdictions’ resolution regimes and the tools available under those regimes should have.

<sup>4</sup> Question 16: Are there other major potential business obstacles to effective resolution that need to be addressed that are not covered in Annex 6: Measures to improve resolvability?

<sup>5</sup> This is the case in various jurisdictions, including the European Union, Singapore, Hong Kong and New Zealand.



**7. Standardization of documentation**

With reference to paragraph 4.2(ii) of Annex 6, we would like to clarify that the reference to the standardization of documentation for payment services is presumably directed at the need for each SIFI to ensure that its customer documentation is consistent with the documentation existing between that SIFI and the relevant FMI. The standard terms of each FMI will have been carefully drafted to reflect the requirements of the market in which it operates and the nature of its systems, so it will not be possible for the FMIs to conform or standardize their terms.

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We greatly appreciate this opportunity to comment in response to the consultation and remain available to answer any questions that the FSB may have concerning our comments. If you have any questions or comments, please contact the undersigned at (212) 943-2293 or Lauren Alter-Baumann, CLS Bank Senior Counsel, at (212) 943-2438.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Alan Bozian', written over a light blue horizontal line.

Alan Bozian  
President and Chief Executive Officer