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Electronically

Financial Stability Board
fsb@bis.org

Re: CLS Bank International's Response to the Financial Stability Board's "Guidance on Continuity of Access to Financial Market Infrastructures ("FMIs") for a Firm in Resolution Consultative Document", 16 December 2016

Ladies and Gentlemen:

CLS Bank International ("CLS") appreciates the opportunity to provide feedback to the Financial Stability Board ("FSB") on the "Guidance on Continuity of Access to Financial Market Infrastructures ("FMIs") for a Firm in Resolution Consultative Document", 16 December 2016 (the "Consultative Document").

Background

CLS is the operator of an FMI that is the predominant settlement system for foreign exchange transactions (the "CLS System"). The CLS System is the world's largest multicurrency cash settlement system, providing payment-versus-payment settlement in 18 currencies directly to 66 Settlement Member banks (hereafter, referred to as "participants"¹), and indirectly to their 23,000 clients.

CLS is an Edge Act corporation regulated and supervised by the Federal Reserve, and has been designated a systemically important financial market utility by the United States Financial Stability Oversight Council. In addition, the central banks whose currencies are settled in the CLS System have established a cooperative oversight arrangement, the CLS Oversight Committee, organized and administered by the Federal Reserve.² As a systemically important payment system, CLS is also subject to the April 2012 CPMI-IOSCO *Principles for financial market infrastructures* ("PFMI"), and publishes a disclosure statement (the "PFMI Disclosure Framework")³ in accordance with its requirements.

General Comments

CLS welcomes the proposals presented in the Consultative Document, and strongly supports the FSB's continued work on global implementation of, and compliance with, the *Key Attributes for Effective Resolution Regimes for Financial Institutions* ("Key Attributes"). CLS firmly believes that continuity of access to FMIs by

¹ Please note that CLS's comments contemplate "participants" as referring specifically to direct participants in the CLS System. CLS does not maintain any contractual relationship with indirect participants.

² The Protocol for the Cooperative Oversight Arrangement of CLS is available at: http://www.federalreserve.gov/paymentsystems/files/cls_protocol.pdf

³ CLS's PFMI Disclosure Framework is publicly available at: <https://www.cls-group.com/About/CG/Pages/CorePrinciples.aspx>

participants in resolution is a common goal that must be prioritized by FMIs and all stakeholders,⁴ so long as continued access does not compromise the continued safe and orderly operations of the FMI (referred to hereinafter as the “shared objectives”).

In light of the critical importance of these shared objectives, CLS has undertaken multiple work streams over the past several years, including: (i) tracking and commenting on proposed implementations of the Key Attributes in various jurisdictions;⁵ (ii) implementing a series of resolution-related amendments to its rules that provide for a fast-track application process for an existing participant to transfer its membership to a successor entity in a resolution scenario and important technical changes; (iii) preparing a comprehensive draft CLS Resolution Planning Checklist designed to assist participants with their own resolution planning, and with respect to the resolution of another CLS participant; (iv) conducting a series of regional workshops to identify and raise awareness of resolution-related issues with participants; (v) preparing an internal CLS Member Resolution Playbook so that CLS is prepared to respond appropriately in the event that one of its participants becomes subject to resolution; and (vi) hosting a Settlement Member Resolution War Game to test resolution-related assumptions and certain sections of the CLS Member Resolution Playbook.

CLS supports the proposed requirements outlined in the Consultative Document, which are an important step forward, subject to the proposed clarifications and enhancements described below.

Implementation

The Consultative Document does not explicitly contemplate that the finalized guidance, when issued, will be subject to jurisdictional implementation. CLS would like to stress the importance of consistency and coordination among the relevant authorities who will be implementing and subsequently enforcing compliance with the final requirements. For CLS, as a cross-border payment system subject to cooperative oversight, it is especially important that national standards be adopted in the context of international norms. Such implementation should also be subject to ongoing monitoring and periodic reporting along the lines that the FSB currently conducts with respect to implementation of the Key Attributes.

Loss of Access

“Loss of access,” as discussed in the context of the Consultative Document, appears to be synonymous with “termination.” However, CLS believes that a mutually agreed suspension for a short period of time may be appropriate in certain circumstances, and may serve to further the shared objectives. Depending on the specific resolution event as well as the individual FMI’s services and design, it may sometimes be preferable to have a temporary suspension period for a short period of time, relating to a specific service or product or currency. This temporary suspension may be preferable to continued participation in an FMI in a situation where it is not clear that all the participant’s obligations can be met, which could potentially (i) result in permanent exclusion of the participant in resolution from the FMI; (ii) result in a loss of market confidence; and (iii) depending on the jurisdiction, result in the termination of legal statutory protections that are necessary for continued participation.⁶ Accordingly, CLS suggests that the final guidance contemplate a temporary loss of access as a possibility that may be appropriate in certain circumstances.

⁴ Including supervisors, regulators and resolution authorities (collectively, “relevant authorities”).

⁵ CLS seeks to ensure that the legal frameworks in all relevant jurisdictions will not inadvertently prevent a participant in resolution from participating in the CLS System (or other similar FMI), which must comply with the PFMI.

⁶ For example, under Article 68(1) of the European Bank Recovery and Resolution Directive (“BRRD”), the fundamental legal protections of the Settlement Finality Directive (“SFD”) are contingent upon satisfaction of substantive obligations under the contract with the designated system. In other words, crisis prevention or crisis management measures under the BRRD may become insolvency proceedings under the SFD if the proviso is not satisfied (*i.e.*, substantive obligations are not performed).

Resolution Timeline

The Consultative Document focuses on the lead up to resolution and the subsequent implementation of resolution action. However, in light of the fact that there will also be actions and requirements applicable to the individual firm and relevant authorities, as well as the affected FMIs, after the resolution action is initiated, CLS suggests that the final guidance reflect the ongoing nature of these actions and requirements.

Responses to Specific Questions

- 1. Does the consultative document appropriately address the tensions that may arise between the various financial stability objectives, with regard to the safety and soundness of providers of critical FMI services on the one hand and to the orderly resolution of the recipients of such services on the other?**

For the reasons set forth in the Consultative Document and in this comment letter, it is not possible to “ensure” continued access.⁷ Accordingly, the FSB may wish to instead consider referring to the need to take the necessary steps to “maximize the likelihood” of continued participation, rather than “ensure” such access.

- 2. Do you agree with the overall scope of the guidance and the proposed definitions, in particular the services and functions captured in the definition of ‘critical FMI services’? Should any of the definitions be amended? If so, please explain.**

Scope

CLS broadly agrees with the overall scope of the guidance, subject to the following amendments and clarifications:

- Exclusion of Central Bank Systems: Whilst cognizant that the FSB’s remit does not encompass central bank systems, the uncertainty with respect to continuity of an institution subject to resolution to maintain access to central bank systems is likely to lead to a market-wide loss of confidence, undermining the success of the resolution action. CLS therefore encourages central bank systems to voluntarily agree with the proposed requirements, and disclose relevant aspects of their compliance.
- Jurisdictional Implications: Global FMIs, like CLS, operate in multiple jurisdictions which have different resolution regimes in different stages of development. The resolution regime in a participant’s jurisdiction may profoundly impact the ability of the participant to maintain access to an FMI. Accordingly, the final guidance should focus on both the jurisdiction of the FMI as well as the relevant jurisdictions of participants.
- Counterparty Resolution Considerations: Whilst cognizant that the scope of the Consultative Document is specifically limited to participant resolution planning, CLS notes that it is also critical for all FMI participants to consider the implications, as well as their potential actions and requirements, with respect to the resolution of another participant in the FMI.

⁷ See, for example, the statement on page 28 of the Consultative Document that, “Firms should be able to maintain and provide to the relevant authorities information to support their assessment of continuity under normal circumstances; and to ensure continuity is maintained in the lead-up to or during resolution” (emphasis added).

Definitions

CLS proposes the following clarifications:

- Resolution: The term “resolution” should not be used interchangeably with the terms “insolvency”⁸ or “the failure of a participant,” since these terms have different implications. For example, “insolvency” may lead to a very different FMI response, depending on the applicable legal framework where the participant is located (*i.e.*, the statutory protections that assure finality of settlement in many jurisdictions in which CLS and other designated systems operate frequently terminate a short time after an insolvency. As a result, participants in insolvency will no longer be able to participate in designated systems after insolvency (as opposed to resolution)).
- Provider of Critical FMI Services: It is important to distinguish between FMIs, custodians, and FMI intermediaries. As the Consultative Document notes, FMIs are subject to the requirements of the PFMI, which include standard contractual arrangements with participants, whereas FMI intermediary contractual arrangements are “... the subject of bilateral agreement with each customer and may be less transparent or uniform than the arrangements between FMIs and their members.”⁹
- Correspondent Banking Services: Given the fundamental role that correspondent banking service providers (also known as nostro agents) play in the daily operations of many FMIs, including CLS, these services should be appropriately and clearly identified within the proposed defined terms. It is not clear where correspondent banking services fall within the Consultative Document (*e.g.*, whether nostro agents are considered FMI intermediaries, whether they fall under critical functions, or whether these are contemplated under ancillary services). If it is an ancillary service, the proposed approach implies that correspondent banking services would fall solely under the responsibility of the contracting party.¹⁰

3. What are your views on the proposal in sub-section 1.1 of the consultative document that providers of critical FMI services clearly set out in their rulebooks or contractual arrangements the rights, obligations and applicable procedures in the event of an FMI participant entering into resolution?

CLS agrees that rulebooks or contractual arrangements should clearly set out the rights and obligations applicable to all parties in the event of an FMI participant entering into resolution. However, given the legal nature of rulebooks and contractual arrangements as well as the need for FMIs to maintain flexibility to address a wide range of scenarios, CLS suggests that it would be helpful for each FMI to provide additional guidance for participants and relevant authorities, tailored to the specific FMI, explaining how the FMI is likely to respond in practice to the resolution of a participant in different scenarios. Such FMI-issued guidance will facilitate an *ex ante* shared understanding of requirements and expectations, issues and concerns and will standardize and streamline communications around expectations and requirements across participants as well as regulators.

⁸ CLS recognizes that insolvency could be a component of a resolution strategy (*e.g.*, transfer to a bridge bank scenario). However, it is important to distinguish between resolution and insolvency as contemplated in the Key Attributes. See, for example, Section 3.1 of the Key Attributes, which states, “Resolution should be initiated when a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so. The resolution regime should provide for timely and early entry into resolution before a firm is balance-sheet insolvent and before all equity has been fully wiped out. There should be clear standards or suitable indicators of non-viability to help guide decisions on whether firms meet the conditions for entry into resolution.”

⁹ Page 13 of the Consultative Document.

¹⁰ See page 13 of the Consultative Document, which specifies that “...responsibility for ensuring the continuity of those ancillary services lies with the relevant FMI, FMI intermediary or FMI participant that contracted them.”

Such guidance may include the following: (i) references to relevant rulebook provisions, including those applicable in a transfer of membership; (ii) a comprehensive resolution timeline, including important decision points; (iii) an overview of mitigants the FMI may utilize, including order of preference; and (iv) descriptions of the various roles a participant may play in the FMI's ecosystem as well as expectations and requirements associated with each, including whether the participant will continue to play such role(s) and any relevant issues/concerns to be considered.

CLS suggests that each FMI be encouraged to proactively engage with its participants with respect to key issues that participants should consider in connection with (i) their own recovery/resolution and FMI participation, as well as (ii) their response to the resolution of another participant in the FMI. All FMIs should explicitly indicate their support of the shared objectives in the guidance described above, as well as in other appropriate documentation.¹¹

- 4. Sub-section 1.1 of the consultative document proposes that the exercise by the provider of critical FMI services of any right of termination or suspension of continued access to critical FMI services arising during resolution of an FMI participant be subject to appropriate procedures and adequate safeguards. What are your views on those procedures and safeguards? In your answer, distinguish where relevant depending on whether the firm that enters resolution continues or fails to meet its payment, delivery and collateral provision obligations to the FMI or FMI intermediary.**

Depending on the design of the particular FMI, it may not be acceptable to wait and see if obligations are fulfilled. While the Consultative Document briefly refers to advance notice,¹² there is no reference to the need for advance assurances, which CLS believes may play a critical role in the ability of a participant in resolution to continue to safely participate in many FMIs. For example, CLS generally does not accept collateral and can only settle payment instructions if its risk management tests are met, including the receipt of payments in applicable currencies. Accordingly, as a result of the design of the CLS System, CLS will seek assurance that payments in relevant currencies will be made, in order to ensure that continued participation will not compromise the CLS System and adversely impact other participants. The same need for *ex ante* assurance will be needed with respect to technical and operational connectivity, as discussed under Question 9. The need for such assurance (which will vary based on the design of each FMI) should be specifically mentioned in the final guidance.

- 5. Sub-section 1.2 of the consultative document proposes that the general rights, arrangements and applicable procedures of a provider of critical FMI services that would be triggered by entry into resolution of an FMI participant, its parent or affiliate, should be the same irrespective of whether the firm entering into resolution is a domestic or foreign FMI participant. What safeguards should be considered and what measures are needed to ensure a consistent approach is taken across providers of critical FMI services to these safeguards?**

CLS agrees in principle that the general rights, arrangements, and applicable procedures that would be triggered by a participant's entry into resolution should be the same irrespective of whether the firm entering into resolution is a domestic or foreign FMI participant. However, care must be taken to ensure

¹¹ For example, CLS includes such statements under its response to Principle 13 in the PFMI Disclosure Framework.

¹² For example, page 23 of the Consultative Document notes "the FMI-Annex, which requires resolution authorities to inform FMIs as soon as possible of the resolution of a participant, and if possible in advance of the firm's entry into resolution. Throughout the period that an FMI participant, its parent or affiliate is in resolution, resolution authorities should provide the FMI with information about the participant or any bridge institution to which its functions have been transferred relevant to the continued participation of that firm or bridge institution in the FMI."

that this important goal is not jeopardized by the legal framework in the jurisdiction of the participant in resolution. It should be clear in all jurisdictions that if a participant from that jurisdiction participates in a foreign FMI, that the foreign FMI will not be compromised by such continued participation as a result of the use of resolution tools with respect to that foreign FMI (e.g., subject to bail-in, or suspension of payments).¹³

- 6. What are your views on the proposal in sub-section 1.4 of the consultative document that providers of critical FMI services should engage with their participants regarding the range of risk management actions and requirements they would anticipate taking in response to the resolution of an FMI participant? Does this strike the right balance between the objectives of orderly resolution and the FMI or FMI intermediary's prudent risk management?**

CLS supports ongoing dialogue between FMIs, their participants, and relevant authorities, and suggests that FMIs should play a supportive, proactive role in furthering these discussions via the guidance and other actions discussed under Question 3. Such communication and engagement will lead to substantially increased understanding for all parties as well as the identification of any additional issues which can be assessed and alleviated as part of coordinated planning efforts well in advance of resolution.

- 7. Do you agree with the proposal in section 2 of the consultative document that firms should be required to develop contingency plans to facilitate continuity of access in both the lead-up to, and upon entry into, resolution? Does the consultative document address all aspects of the information and analysis that may be required for such contingency plans?**

FMIs should have appropriate and clearly defined lines of communication to, and engagement with, relevant authorities, and where appropriate, engage with institution-specific Crisis Management Groups ("CMGs") that have been working to develop resolution strategies and recovery and resolution plans. This will enable FMIs to provide appropriate information to CMGs,¹⁴ especially regarding requirements, concerns, or issues to be addressed to maximize the likelihood of continued participation in a resolution scenario.

- 8. Are there any aspects of the proposed guidance that should apply differently according to whether access to a critical FMI service is provided directly by an FMI or custodian, or indirectly by an FMI intermediary? If so, please describe with reference to the particular section(s) of the proposed guidance, and include your views on how that section(s) should differ.**

CLS supports the view that an FMI needs to understand the risks associated in the relationships between direct participants and their customers (indirect participants) in order to be able to understand and assess what risks, if any, the tiered arrangements may present to the FMI, its system/service and other participants. CLS believes that the final guidance should make clear that an FMI should raise awareness of these risks from the perspective of the FMI through proactive outreach efforts to its direct participants. As noted in the comments under Definitions, CLS recommends that the final guidance be clarified to distinguish between direct and indirect participants.

¹³ For example, in recognition of the important role played by FMIs, the BRRD currently provides for certain protections to SFD designated systems, including exemptions from the impact of various resolution tools. These exemptions do not extend to other systems, even if EU banks participate in these systems.

¹⁴ It is important for FMIs to be able to share information with other CMG participants, and to ensure that confidentiality protections will apply to all disclosures within the CMG.

9. **Does the consultative document identify all relevant requirements and pre-conditions that a firm may need to meet to support continuity of access in both the lead-up to, and upon, resolution? What other conditions or requirements, if any, should be addressed?**

CLS generally supports the requirements and pre-conditions identified in the Consultative Document, subject to the comments provided below.

Transfer of Membership

CLS agrees that contingency as well as resolution plans must contemplate the possibility of a transfer of participation to a successor entity, including a bridge bank. It is generally acknowledged that in a time sensitive transfer scenario, operational and technical connectivity cannot change, since changes require a significant amount of advance planning and testing. However, FMIs and other stakeholders will need to receive timely notice as well as assurance that operational and technical connectivity will not change. This issue is particularly critical in circumstances where rights and obligations may transfer as a matter of law in the jurisdiction of the participants, while the asset or other right subject to transfer is governed by the law of another jurisdiction.¹⁵

Testing

With respect to Section 1.4 of the Consultative Document, CLS recommends clarifying the language in the final guidance to state that “Providers of critical FMI services should be required to test the effectiveness of their relevant rules, contractual arrangements and procedures addressing a resolution scenario regularly through simulations, tabletop exercises, or other means, as feasible and appropriate, for example including governance, operations or arrangements to expedite the transfer of participation or membership to a third-party successor or bridge institution.” Such exercises can be conducted on a domestic or an international scale, and would allow participants to walk through a resolution scenario, identify the issues that may arise, and discuss appropriate coordination and actions to address potential impediments without adversely impacting the effective functioning of the global financial markets. FMIs should be encouraged to summarize key findings and takeaways for their participants as well as relevant authorities.

10. **Does the consultative document identify appropriate methods for providing the information and communication necessary for key decision making during the resolution of an FMI participant? Are there additional safeguards that could be put in place that would ensure adequate levels of transparency in the lead-up to, and upon resolution?**

CLS suggest the following additional safeguards, that could be put in place and that would facilitate adequate levels of transparency in the lead-up to, and upon resolution.

Appropriate Communication Methods

Communications processes and protocols should be clearly established and understood across all FMIs, participants, and relevant authorities. Specifically:

- **Notification Template:** As noted under Question 4, advance notice may be necessary for continued participation in various FMIs, and should therefore be highlighted in the final guidance. In addition,

¹⁵ For example, consider the scenario where rights and obligations of a participant transfer in a relevant jurisdiction by operation of law to a bridge institution. In this circumstance, what is the impact on the participant’s SWIFT BICs, presumably governed by SWIFT’s rules?

CLS believes it could be beneficial for relevant authorities and FMIs to discuss and reach agreement regarding the form and content of a standard notification template (tailored to specific types of FMIs).

- FMI Interaction with Resolution Authorities: CLS strongly supports the proposed guidance that, “Where not already in place, the resolution authorities should put in place appropriate information sharing arrangements with the relevant authorities of providers of critical FMI services in order to establish communication channels that facilitate the sharing of information both before and during the resolution of a firm.”¹⁶ However, CLS suggests that the final guidance should also emphasize the need for direct engagement of resolution authorities with FMIs, as necessary and appropriate, in certain circumstances. For example, direct engagement is likely to be necessary in time sensitive scenarios where circumstances are quickly evolving and the resolution authority and the FMI each require information in order to make important decisions. In this case, it is more efficient for FMIs and resolution authorities to engage directly, in order to (i) further a shared understanding of the issues; and (ii) expedite the sharing of critical information (please refer to the comment below relating to “updated transactional information”).

As noted under Question 7, CLS encourages relevant authorities (including CMGs) to engage directly with FMIs¹⁷ and to consider the appropriate methods for sharing information during the development of contingency and resolution plans, as well as if a participant is subject to resolution. Specific considerations and clarifications should contemplate any non-disclosure or other confidentiality agreements that may need to be put in place as well as clear identification of specific individuals authorized to discuss, make decisions, provide information, and ultimately execute any required documents across all relevant parties.¹⁸

- Updated Transactional Information: CLS agrees that participants should be aware of, and to the extent practicable, provide their respective authorities with “[a]n inventory of material upcoming settlement and delivery obligations by value and type of asset for a specified upcoming period to and/or via FMIs and FMI intermediaries.”¹⁹ However, it is likely that in a resolution scenario, these obligations will be subject to change and therefore: (i) FMIs should expressly consider their ability to provide resolution authorities with up-to-date information on relevant transactions and obligations, if requested,²⁰ and (ii) resolution authorities should expressly consider the need for information from FMIs on a real time basis, which will require direct engagement with FMIs. Based on the information provided, resolution authorities may also need to engage directly with clients of the participant in resolution, or other stakeholders, as circumstances evolve.

Market Confidence

CLS believes that market confidence in the credibility as well as feasibility of a resolution process will be fundamental to the ultimate success of the resolution action and therefore to the institution’s continued participation in relevant FMIs. FMIs can facilitate communications and therefore help reinforce market confidence so long as they are fully integrated into the resolution process, but this requires advance

¹⁶ Page 25 of the Consultative Document.

¹⁷ As noted on page 23 of the Consultative Document, “Resolution authorities of FMI participants are required to develop, prepare for and execute resolution plans that achieve resolution objectives, including the maintenance of a firm’s critical functions in resolution.”

¹⁸ This consideration is already contemplated with respect to communications between regulatory authorities of FMIs and resolution authorities in Section 3.3 Information sharing between authorities and early warning of risks. This aspect of the guidance could be expanded to also contemplate direct engagement between resolution authorities and FMIs.

¹⁹ Page 29 of the Consultative Document.

²⁰ This information will also relate to the multiple roles that the participant may play with respect to an FMI (e.g., functions it performs for other participants), as applicable.



notice to FMIs as outlined above, clearly established lines of communication, and significant pre-planning across the entirety of the global markets.

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

Sincerely,

A handwritten signature in blue ink, appearing to read 'Dino Kos', written over a blue circular scribble or flourish.

Dino Kos

cc:

Gaynor Wood, General Counsel, CLS Group

Lauren Alter-Baumann, Managing Director, Legal and Regulatory Strategic Affairs, CLS Bank International

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