

2 February 2018

Via Electronic Mail

Financial Stability Board
Email: fsb@fsb.org

Ladies and Gentlemen:

Re: Consultative Document on Funding Strategy Elements of an Implementable Resolution Plan

CLS Bank International ("CLS") welcomes the opportunity to submit these comments regarding the consultative document, "Funding Strategy Elements of an Implementable Resolution Plan", published by the Financial Stability Board ("FSB") on 30 November 2017 (the "Consultative Document").

CLS supports the objectives and principles expressed in the Consultative Document, including the need for resolution funding plans. As a systemically important financial market infrastructure ("FMI"), CLS fully understands the need to ensure continuity of access to FMIs for a global systemically important bank ("G-SIB") in resolution and seeks to cooperate with, and assist, resolution authorities. However, CLS suggests that the FSB provide additional guidance with respect to issues that should be addressed in resolution funding plans, including liquidity needs in foreign currencies. In particular, for the reasons described below, CLS suggests that the role of correspondent banks (referred to as nostro agents) should be specifically identified in resolution funding plans and that plans should consider how best to ensure that nostro agents continue to perform for G-SIBs in resolution, so that these G-SIBs are able to comply with their obligations to FMIs in all relevant currencies. CLS also suggests that the Consultative Document address the need for clear communication to the market prior to resolution, upon entry into resolution and during resolution, since market confidence will, in part, affect the amount of funding ultimately required to assure the G-SIB can meet its obligations.

I. Background

CLS is the operator of the CLS settlement system (the "CLS system"), which is the world's largest multicurrency cash settlement system, providing payment-versus-payment settlement in 18 currencies directly to 67 settlement members ("Members") and indirectly to their 24,000 clients.¹

CLS settles payment instructions relating to underlying foreign exchange transactions. In order for these payment instructions to settle, Members must satisfy their payment obligations (or "funding obligations") to CLS in these 18 currencies, as applicable, at very specific times of day. These payments are generally made through nostro agents in all relevant jurisdictions. CLS notes that settlement and funding in the CLS system are separate processes, but are linked and run in parallel operationally. In contrast to settlement, which takes place on a gross basis across each Member's account on CLS's books, funding obligations are calculated on a multilaterally netted basis, taking into consideration all Members' payment instructions

¹ 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.

scheduled for settlement in the relevant settlement session for each eligible currency on the relevant settlement date. All Members benefit from a payment netting benefit of approximately 96% (i.e., only 4% of the value of the settled payment instructions, in the relevant currencies, must be paid into CLS for these instructions to settle). Most Members further increase these netting benefits through use of a CLS In/Out swap liquidity management tool (referred to as the “In/Out Swap Program”), where Members participate in swaps with other Members based on limits they have bilaterally set with these other Members, which they are free to adjust at any time.² As a result of participation in the In/Out Swap Program, netting benefits increase from 96% to approximately 99%.

Timely compliance with funding obligations is absolutely critical for CLS, since the failure of a Member in resolution to comply with these obligations (i) may result in unsettled payment instructions (also impacting other Members) and the suspension of the Member in resolution from the CLS system and (ii) may also trigger CLS’s failure management procedures. Depending upon the nature, scope, and severity of the Member’s failure to meet its funding obligations to CLS, there could be adverse consequences for CLS and other Members (e.g., CLS may need to draw down on its committed liquidity facilities or make payments in alternative currencies to non-defaulting Members) that have the potential to significantly impact the broader financial markets. CLS notes that the failure of a Member in resolution to meet its funding obligations to a systemically important payment system in a timely manner is also likely to result in diminished market confidence (which will in turn inform the decision-making process of the G-SIB’s counterparties and its nostro agents in relevant jurisdictions) at a critical time, which may negatively impact upon the viability of the resolution.

II. Response to Question 1: Do the funding strategy elements in the consultative document address all relevant aspects of a resolution funding plan? What other aspects, if any, should be considered?

a. Acknowledge the role of nostro agents

CLS suggests that resolution funding plans should also acknowledge the important role played by nostro agents with respect to funding in foreign currencies, and emphasize the need to ensure that nostro agents will continue to perform this function for a G-SIB in a time-sensitive resolution scenario. In order to accomplish this goal, CLS proposes that resolution funding plans should also:

- address the need for appropriate information sharing and coordination with relevant authorities in jurisdictions where nostro agents are located (and not just among jurisdictions where home and host authorities are located).³ CLS believes that it is important for relevant authorities in jurisdictions where certain nostro agents are located (e.g., those that perform an important function for the G-SIB in question, such as providing funding to FMIs) to understand the role that these nostro agents will be asked to play during a resolution, so that these authorities can assist in the advance planning process

² As noted, Members are responsible for establishing limits with other Members. As a result, in a resolution scenario, absent sufficient information from resolution authorities or other relevant regulators designed to alleviate the concerns of the other Members, the other Members are highly likely to cut these limits, substantially increasing the size of the pay-in requirements for the Member in resolution in all relevant currencies. CLS conducted a War Game in 2016, and the participants that played the hypothetical roles of other Members (i.e., other than the Member in resolution) universally indicated that they would reduce their In/Out swap limits with the Member in resolution. As also noted above, limits can be changed at any time by Members, including over the course of a resolution weekend.

³ CLS therefore suggests that these authorities should also be referenced in section 5.2 of the Consultative Document (Cooperation and information sharing among the relevant authorities).

and provide assistance prior to resolution, upon entry into resolution, and during resolution. These authorities could serve as a conduit for information between the resolution authority and nostro agents in time-sensitive situations.

- specify how FMIs will receive assurance regarding whether obligations to such FMIs will be met, including funding obligations in foreign currencies. As explained, funding in a timely manner in 18 currencies (as applicable) is central to the ability of CLS to continue to allow a Member in resolution to continue to participate in the CLS system. Failure to fund can have an adverse impact on (i) the CLS system and other Members, whose funding obligations have been calculated on the basis that all other Members will comply with their funding obligations in multiple currencies⁴ and (ii) the broader financial markets. In order to protect the CLS system and its other Members, prior to the next settlement session, CLS will attempt to seek assurance from relevant authorities, the Member in resolution and from relevant nostro agents regarding whether or not the Member will in fact meet all of its funding obligations in relevant currencies. If CLS does not receive such assurance, depending on the specific facts and circumstances, it is possible that CLS might need to temporarily suspend the G-SIB in resolution or take other steps, which could have an adverse impact on the resolution.
- identify requirements that nostro agents will impose, such as the need for collateral in specific foreign currencies, and consider how to address these requirements. Resolution funding plans should consider how these requirements will be met in a timely manner (including through the use of any standing swap lines that are established among the central banks that are involved, as necessary) and an effective means for communicating with nostro agents prior to resolution, upon entry into resolution, and during resolution. As suggested above, the plans should also contemplate engagement with relevant authorities in jurisdictions where nostro agents are located.

b. Prepare a comprehensive communication strategy

As indicated in the Consultative Document, G-SIBs should have a methodology to estimate aggregate liquidity needs, including obligations relating to their payment, clearing and settlement activities. CLS notes, however, that a lack of market confidence is likely to have a negative impact on the liquidity demands that will be placed on the G-SIB in resolution.⁴ For example, as described above, when CLS conducted a resolution War Game in 2016 attended by other Members and certain regulators, other Members (i.e., other than the G-SIB in resolution) universally indicated that in response to the resolution they would cut their In/Out swap limits with the Member in resolution. As a result, the pay-in amounts to CLS in foreign currencies dramatically increased (and therefore the need for liquidity in these currencies).

Accordingly, CLS believes that it is important for resolution authorities to specifically consider how they will provide information and assurance to the market in general, including key counterparties and nostro agents, which will influence counterparty behavior and the need for liquidity. CLS suggests that at a minimum, resolution funding plans should explicitly set forth a strategy for promptly communicating with important stakeholders (identified by CMGs) in a resolution scenario,

⁴ Section 2.4 of the Consultative Document (Maintaining adequate liquidity in different currencies) also acknowledges that “there may be shortfalls in particular currencies during resolution due to, for example, operational or timing constraints, or counterparty reluctance to swap significant amounts of currency in the period immediately following entry into resolution.” CLS believes that a comprehensive communication strategy could positively influence the behavior of key counterparties.

in addition to a strategy for communicating with FMIs with respect to important components of the funding strategy. These components could include: (i) any contemplated access to temporary public sector backstop funding in domestic currencies, and (ii) the approach for ensuring payments in foreign currencies.

Along the same lines, CLS also suggests that a section of each resolution funding plan should be prepared for public distribution; this section would convey key policies and information to the public, and would be designed to reassure the market that relevant authorities have the ability to ensure that funding obligations in all currencies will be met in certain circumstances.⁵

III. Clarification/ Section 4.4 of the Consultative Document (Access to ordinary central bank facilities and payment and settlement systems by material operating entities of a firm in resolution)

Section 4.4 provides that, "The resolution funding plan should contain measures to promote continuity of access by material operating entities of a firm in resolution to ordinary central bank facilities, **including payment and settlement systems (emphasis added)**, in home and host jurisdictions as required to implement the resolution strategy and operationalize access to relevant private and public funding mechanisms, where local requirements and conditions for access are met (e.g., where those entities are not themselves in resolution)."

While CLS fully supports the spirit of this paragraph, CLS suggests revising the text to clarify that "payment and settlement systems" include both central bank and non-central-bank facilities, such as the system operated by CLS.

Finally, we suggest amendments to section 4.4 that specifically emphasize the need for measures to promote continuity of access to payment and settlement systems, including those systems that are operated by central banks.⁶

CLS appreciates the FSB's consideration of the views set forth in this letter and would welcome the opportunity to discuss these comments in further detail.

Sincerely,



Dino Kos
Chief Regulatory Officer

cc: Lauren Alter-Baumann, Head of Regulatory Strategy

⁵ The Bank of England has recently updated its public policy statement, "The Bank of England's Approach to Resolution," including Box 2 (of Part 2), entitled "The Bank's approach to providing liquidity in resolution. The Bank of England specifically references central bank facilities, but also makes clear that that the Bank of England has the tools to lend to banks and other institutions subject to the resolution regime, where the entity or its holding company is in a Bank of England-led resolution, secured against a wide range of collateral. The Bank of England's objective would be "to provide liquidity in sterling or foreign currency as required, in the necessary scale and for a sufficient period of time to allow the firm to make the transition to market-based funding."

⁶ CLS also suggests similar conforming amendments with respect to the first paragraph of section 4 which refers to "ordinary central bank facilities, including payment and settlement systems" and the last paragraph of section 4 which refers to "maintaining continued indirect access to ordinary central bank facilities by material operating entities (e.g., access to payment or settlement systems) through correspondent relationships with affiliated entities) and any possible constraints or technical impediments to indirect access (e.g., restrictions related to on-lending)."