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David W. Puth
Chief Executive Officer

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Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel, Switzerland

Via Email: baselcommittee@bis.org

Re: CLS Bank International Response to the Basel Committee on Banking Supervision's ("BCBS") Consultative Document entitled Supervisory Guidance for Managing Risks Associated with the Settlement of Foreign Exchange Transactions (the "BCBS Consultative Paper")

Dear Colleagues:

CLS Bank International ("CLS") welcomes the opportunity to comment on the BCBS Consultative Paper.

CLS came into existence as the result of the collaborative efforts of foreign exchange market participants and various central banks, including the Board of Governors of the Federal Reserve System in the United States, the European Central Bank and the Bank of England, in response to regulatory concerns regarding foreign exchange settlement. Beginning in the mid-1990s, central banks became increasingly concerned that the high level of settlement risk in existing practices, coupled with an unexpected event or failure, could trigger a serious disruption in the global foreign exchange ("FX") markets and financial system liquidity. One of the key recommendations in the Allsop report prepared by the Committee on Payment and Settlement Systems and published by the Bank for International Settlements in 1996 was for industry groups to develop an FX settlement risk-reducing multi-currency service that would protect against the loss of principal. As a result, CLS was established as a payment versus payment ("PvP") system to mitigate settlement risk—loss of principal—associated with the settlement of payments relating to FX transactions. CLS is now the predominant settlement system for FX and provides a PvP settlement service for 17 currencies, including all of the currencies represented by the central bank contributors to the Allsop report. Over the years, CLS has grown consistently with the FX market to mitigate settlement risk and plans to extend its risk mitigation service by adding new currencies and more settlement members. CLS looks forward to the active involvement of additional central banks for prospective currencies, as their advocacy is critical in establishing the policy framework for currency participation. Today, CLS serves over 60 Settlement Members, all of which are financial institutions subject to prudential regulation and supervision, and thousands of third-party users. CLS extended its service to single currency payment instructions relating to non-deliverable forward FX transactions and over-the-counter credit derivative transactions in 2007. CLS has a demonstrated history of reducing settlement risk in FX markets, including during the 2008 financial crisis, when the CLS system and the foreign exchange markets functioned effectively.



CLS broadly supports the views expressed in the BCBS Consultative Paper and, in particular, strongly agrees with the fundamental premise of Guideline 2: namely, that the primary means by which banks should eliminate principal risk when settling FX transactions is, where practicable, the use of FMI that provide PVP settlement. Unlike other OTC derivatives, settlement risk (loss of principal) is generally understood to be the primary risk associated with the settlement of payments relating to FX transactions. In the non-FX OTC market, central clearing is considered by regulators to be the primary means of credit risk mitigation. For the FX market, where settlement risk is primary, CLS believes that the use of FMIs that provide PVP settlement in the FX market should be strongly encouraged.¹

Key consideration 1 of Guideline 2 provides that “[a] bank should eliminate principal risk by using FMIs that provide PVP settlement, where practicable.” As discussed later in the BCBS Consultative Paper, a bank may access the services of a PVP arrangement as a direct participant or as an indirect participant. Regardless of the form of access, however, the policy is the same: banks should maximize their use of PVP arrangements. Given the importance of that policy, CLS suggests that further clarity be provided on when the use of an FMI that provides PVP settlement would be “practicable” for a bank. CLS recognizes that the BCBS Consultative Paper provides examples of why a bank “may still have trades that cannot be settled through a PVP arrangement (e.g. certain same day trades, or trades in certain currencies or with counterparties not eligible for PVP settlement)” and thus may serve as implicit examples of situations where PVP may not be practicable. However, CLS believes that the FX market and its participants would benefit from an express description of when the use of an FMI that provides PVP settlement would be practicable for banks and other parties to FX transactions (e.g. where that bank and its counterparty meet the eligibility requirements to participate either directly or indirectly in that PVP arrangement and payments relating to that FX transaction are eligible to be settled under that PVP arrangement).

Further, CLS would expect that any regulatory measures developed and implemented to address replacement cost risk on deliverable FX, such as those raised in the BCBS/IOSCO Consultative Document on Margin Requirements for Non-Centrally Cleared Derivatives, give appropriate consideration to the impact on the broader FX market and the potential for unintended adverse consequences for settlement risk management and mitigation.

Please do not hesitate to contact me if you have any questions regarding this submission.

Sincerely,

A handwritten signature in dark ink, appearing to read "David W. Puth".

David W. Puth
Chief Executive Officer

cc: Gerard Hartsink, Chairman of the Board, CLS Bank International
Michele Fleming, Chief Compliance Officer & Interim Chief Legal Officer, CLS Bank International
Lauren Alter-Baumann, Managing Director & Associate General Counsel, CLS Bank International
David A. Trapani, Executive Director & Associate General Counsel, CLS Bank International
Thomas C. Whitford, Executive Director Regulatory Affairs, CLS Bank International

¹ Such a position also would be consistent with, and a natural extension of, the strategy agreed and implemented through close cooperation of the public and private sector in addressing settlement risk in the FX market through the establishment of CLS's PVP settlement service, which has become the predominant multicurrency settlement system for FX transactions globally.