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February 1, 2016

Via electronic mail

Bank of Canada/Banque du Canada
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E-mail: PFMI-consultation@bankofcanada.ca

Re: Public Consultation on policy guidance on the Bank of Canada's risk-management standards for designated financial market infrastructures, Standard 24: Recovery Plans (the "Policy Guidance")

Dear Sirs/Mesdames,

CLS Bank International ("CLS"), the operator of the CLS settlement system (the "CLS System"), appreciates the opportunity to comment on the Policy Guidance implementing the CPMI-IOSCO Principles for Financial Market Infrastructures ("PFMI") and supplying additional clarity regarding recovery and orderly wind-down plans for designated financial market infrastructures ("FMIs").

Background

CLS is a special purpose corporation organized under the laws of the United States of America and is supervised by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York. CLS also is subject to cooperative oversight by 23 central banks, including the Bank of Canada, pursuant to the Protocol for the Cooperative Oversight Arrangement of CLS.[1] The CLS System is a designated system in Canada under the Payment Clearing and Settlement Act, and CLS Bank also is an exempt clearing agency in Ontario.[2]

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1 The Protocol is available at http://www.federalreserve.gov/paymentsystems/files/cls_protocol.pdf.

2 Additionally, CLS has been designated under finality legislation in various other jurisdictions and also has been designated as a systemically important financial market utility by the United States Financial Stability Council.

CLS's Comments

Application of the Policy Guidance

The Policy Guidance references application to "designated domestic FMIs." Policy Guidance, page 1. As stated above, CLS is designated under Canadian law, but is not "domestic" as it is a registered entity with its physical presence in the United States. Accordingly, CLS is subject to the PFMI via the relevant implementing statute in the United States. Therefore, in order to avoid ambiguity and prevent duplicative and disparate applications of the PFMI, CLS respectfully requests that the Policy Guidance clarify that international FMIs designated under Canadian law, with head offices outside of Canada, are exempt from compliance. CLS of course welcomes comments and guidance on its recovery plan from the Bank of Canada through its role on the CLS Oversight Committee.

Triggers for recovery

CLS agrees with the statement that "an FMI should be prudent in its actions and err on the side of caution." Policy Guidance, page 3. Therefore, although there may be value in an FMI "detailing in advance their communication plans [in a recovery scenario]," as prescribed in the Policy Guidance, FMIs must always balance communication against their responsibility to maintain the confidence of the market. Thus, the means and manner in which distress or a recovery is communicated to the market, assuming it is in the circumstances appropriate to communicate it at all, may vary greatly depending on the circumstances surrounding the distress and how such information may be perceived by participants and the market. Therefore, while it is appropriate to communicate the occurrence of a recovery trigger with regulators and the FMI's Board of Directors, communication plans should otherwise not be overly prescriptive or require communications with any particular stakeholder.

A comprehensive plan for recovery

Although CLS agrees with the general statement that a robust recovery plan relies on "a range of tools to form an adequate response to realized risks," CLS believes that "recovery tools" should be as well defined as possible by the Policy Guidance, taking into account that there are different types of FMIs. Policy Guidance, page 4. "Recovery" concerns the ability of an FMI to recover from a threat to its viability and financial strength so that it can continue to provide its critical services without requiring the use of resolution powers by authorities. CPMI-Guidance, at 1.1.1. In light of this definition, it is important to draw a clear and appropriate distinction between recovery and business continuity management, and the tools associated with each discipline, so that the recovery plan addresses the correct objectives.

Recovery from non-default-related losses and structural weaknesses

The Policy Guidance states that "[s]tructural weakness can be an impediment to the effective rollout of recovery tools" and that FMIs should "promptly identify, evaluate and address the sources of underlying structural weakness on a continuous basis (e.g., unprofitable business lines, investment losses) and the tools available to address them within a concrete time frame." Policy Guidance, page 7. CLS does not disagree with this language per se, but cautions that FMIs should promptly address unprofitable

business lines and investment losses at all times, regardless of whether the recovery plan has been triggered, and that a competent board and management should be expected to do so. For this reason, these are general considerations and necessarily recovery plan issues.

Legal consideration for full allocation

The Policy Guidance states that "FMIs should consider whether it is appropriate to involve indirect participants . . . in the allocation of losses and shortfalls during recovery" and that "[s]uch loss or shortfall allocation arrangement should have a strong legal and regulatory basis." Policy Guidance, page 8. In cases where FMIs do not maintain a legal contractual relationship with third party users, they have limited influence on such users and on the commercial relationships between such third party users and the direct participants that provide them with their services. In such cases, it may be beneficial for regulators to encourage direct participation in FMIs whenever such participation is practical and permissible in accordance with the FMI's rules, so that losses can be mutualized among a larger group, thus reducing the systemic impact of a defaulting participant and the size of cash calls generally (assuming losses are shared *pro rata*), should they occur.

Annual review of the recovery plan

CLS notes that the Policy Guidance provides that "[a]n FMI should review and, if necessary, update its recovery plan on an annual basis." Policy Guidance, page 10. Because *ex ante* agreements with relevant stakeholders are central to an FMI's recovery and orderly wind-down plan, and these agreements take time to amend or to draft, negotiate and discuss with stakeholders and regulators, reviews and updates of plans should be undertaken no more frequently than every other year, unless in the interim there are material changes to the designated FMI's system or regulatory environment. Further, CLS notes that the requirement that a recovery plan be subject to approval by the FMI's board of directors is slightly different from the CPMI-ISOCO Guidance that is cited in the Policy Guidance, which requires formal "endorsement" by the board of directors or equivalent governing body. CPMI Guidance at 2.3.3.

Orderly wind-down plan

CLS agrees with the statement in the Policy Guidance that "developing an orderly wind-down plan may not be appropriate or operationally feasible for some critical services." Policy Guidance, page 11. The orderly wind-down of a systemically important FMI may be inappropriate, particularly where a viable alternative to using that particular FMI does not exist. Therefore, in such a case, CLS would recommend that an orderly wind-down plan not be required.

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Please do not hesitate to contact us if you have any questions or otherwise would like to discuss this letter.

Sincerely,

Alan Marquard

cc: Dino Kos, Head of Regulatory Affairs, CLS Group
Andrea Gildea, Director, Assistant General Counsel, CLS Bank International