Responses to the Discussion Paper on the Clearing Obligation under EMIR

A. Respondent

Name: CLS Bank International

Country: USA

Category: please use the table below

Category	Please select
Audit/Legal/Individual	
Banking sector	
Central Counterparty	
Commodity trading	
Government, Regulatory and Enforcement	
Insurance and Pension	
Investment Services	
Non-financial counterparty subject to EMIR	
Regulated markets/Exchanges/Trading Systems	
Other Financial service providers	x

B. Introduction – General comments

As ESMA is aware, CLS Bank International, ("CLS Bank") is an Edge Act corporation located in New York, with its affiliate CLS Services Ltd. located in London. In 2012, the U.S. Financial Stability Oversight Council designated CLS Bank as a systemically important financial market utility in the United States. CLS Bank's payment-versus-payment settlement service is the predominant settlement system for foreign exchange globally. CLS Bank was created as the result of the collaborative efforts of foreign exchange market participants and various central banks, including the European Central Bank and the Bank of England, in response to regulatory concerns regarding foreign exchange settlement. CLS Bank has a demonstrated history of reducing settlement risk in foreign exchange markets, including during the 2008 financial crisis, when the CLS system and the foreign exchange markets functioned effectively.

CLS settles FX spot, forward, and swaps, which constitute 94% of the FX products traded, according to the Triennial Central Bank Survey of Foreign Exchange and Derivatives and Market Activity in 2010. CLS also settles exercised FX options. CLS currently settles an average of $4.9 trillion daily.

C. Comments on the discussion paper and answers to questions

5.2. Foreign exchange OTC derivatives

Comments on paragraphs 139 to 140:

> **Question 33 (FX derivatives): Within the foreign exchange asset class, for which type of contracts do you consider that settlement risk is the predominant risk, and what criteria or characteristics should be used by ESMA to identify those contracts?**

Answer 33:

Settlement risk is the overwhelmingly predominant risk for deliverable FX transactions, regardless of transaction type (*e.g.*, FX forwards and FX swaps) or tenor. As a result, ESMA should distinguish between deliverable (*i.e.*, physically-settled) and non-deliverable (*i.e.*, cash-settled) FX transactions for the purpose of identifying contracts for which settlement risk is the predominant risk.

More importantly, ESMA should not apply a mandatory clearing obligation to deliverable FX transactions. Given the global nature of the FX market, it is important that FX transactions are subject to consistent regulatory treatment in all jurisdictions. If ESMA were to apply a mandatory clearing obligation to deliverable FX transactions, it would be contrary to the emerging views of regulators globally with respect to deliverable FX forwards and FX swaps. For example, in November 2012 the Department of the Treasury effectively exempted FX forwards and FX swaps from the potential application of any mandatory clearing obligation in the United States. In reaching its determination after extensive study and consultation, the Department of the Treasury recognized that the risk profile of FX forwards and FX swaps is largely concentrated on settlement risk—as opposed to counterparty credit risk prior to settlement—and that the market for those transactions relies on the extensive use of payment-versus-payment settlement arrangements such as CLS that virtually eliminate settlement risk. Ultimately, the Department of Treasury concluded that the challenges associated with applying a mandatory clearing obligation to FX forwards and FX swaps would outweigh the benefits that central clearing would provide. For the same reasons, ESMA should not apply a mandatory clearing obligation to deliverable FX transactions.

We also fully support the clear Level 1 guidance in the Recital 19 of EMIR which recognises that the predominant risk for transactions in some classes of OTC derivative contracts (such as FX) relates to settlement risk and the regime for such contracts should rely, in particular, on preliminary international convergence and mutual recognition of the relevant infrastructure.