

29 September 2017

Via electronic submission

House of Lords  
European Union Committee  
Financial Affairs

**Re: CLS Bank International's Response to the House of Lords Inquiry into Financial Regulation and Supervision Following Brexit / Call for Evidence (the "Call for Evidence")**

Ladies and Gentlemen:

CLS Bank International ("**CLS**") welcomes the opportunity to submit these comments in response to the Call for Evidence, including Question 4 (i.e., particular legal or practical challenges relating to incorporating EU financial services legislation into the UK's domestic law).

**I. Background**

1. CLS is a special purpose Edge Act corporation organized under the laws of the United States that is regulated and supervised by the Federal Reserve and designated as a systemically important financial market utility by the United States Financial Stability Oversight Council. CLS is the operator of a payment-versus-payment system established by the private sector to mitigate settlement risk (loss of principal) associated with the settlement of payments relating to foreign exchange transactions (the "**CLS System**"). CLS is subject to demanding regulatory standards and risk management requirements under the Federal Reserve's Regulation HH as well as the CPMI-IOSCO's *Principles for financial market infrastructures* (the "**PFMI**").
2. The central banks whose currencies are settled in the CLS System have established a cooperative oversight arrangement, the CLS Oversight Committee ("**OC**"), organized and administered by the Federal Reserve. The OC provides the 23 participating central banks, including the Bank of England, a mechanism to carry out their individual responsibilities for the safety and efficiency of payment and settlement systems, and the stability of the financial system.
3. The CLS System was designated in the United Kingdom in 2002 by the Bank of England for the purposes of the Financial Markets and Insolvency (Settlement Finality) Regulations 1999/2979, as amended (the "**SFRegs**"), which implement the Settlement Finality Directive 98/26/EC, as amended (the "**SFD**"), in the UK.<sup>1</sup> As a result of CLS's designation under the SFRegs, CLS and its participants benefit from the important statutory protections provided by the SFRegs, including finality of settlement and enforceability of netting and default arrangements.

---

<sup>1</sup> The CLS System is also designated or recognized for the purposes of comparable finality legislation in many other jurisdictions.

CLS Group

Exchange Tower  
One Harbour Exchange Square  
London E14 9GE

T + 44 (0)20 7971 5700  
info@cls-group.com  
cls-group.com

CLS UK Intermediate Holdings Ltd.  
Reg. England No. 3391758.  
Reg. Office: Exchange Tower.  
One Harbour  
Exchange Square. London E14 9GE

4. In order to ensure the ability of UK participants to continue to safely participate in systems that are currently designated under the SFD (including systems designated under the SFRegs), CLS believes that two basic issues described below should be considered and addressed when implementing the SFD into the UK's domestic law. Additional issues may apply with respect to other systems designated under the SFRegs.

## **II. Issues to be addressed after Brexit**

### **1. Systems that are currently designated under the SFRegs should remain designated and continue to benefit from all the protections set forth therein**

As noted above, CLS is subject to the PFMI, including Principle 1: Legal basis and Principle 8: Settlement finality. As a result of its designation under the SFRegs, CLS currently complies with these requirements as a matter of English law. Accordingly, it is critical to ensure that after Brexit, systems that are currently designated under the SFRegs will remain designated and will continue to benefit from the protections conferred by the SFRegs. Since, in a number of places, the SFRegs cross-reference defined terms from European directives, including the SFD and Bank Recovery and Resolution Directive 2014/59/EU, prior to incorporating these terms into UK domestic law, it is important to review these terms in close coordination with designated systems. This type of review is necessary to avoid potential unintended consequences and to ensure that the SFRegs will remain fit for purpose for designated systems and their participants after Brexit.

### **2. Systems that are not governed by English law, including systems designated under the SFD by EU Member States, should be able to benefit from the protections of the SFRegs**

The SFRegs currently provide that only systems that are governed by the law of England and Wales, Northern Ireland or Scotland may be designated under the SFRegs. This requirement mirrors the requirements set forth in the SFD, which provide that a system must be (i) governed by the law of a Member State and (ii) designated by the Member State whose law is applicable. CLS believes that this requirement is highly problematic for participants in both EU and UK systems, as well as for the systems themselves. As far as CLS is aware, the EU (including the UK, as a Member State) is the only jurisdiction that has implemented this type of requirement for designation. As a result, it is not possible for systemically important systems that are governed by the laws of a jurisdiction other than the law of a Member State (which will exclude systems governed by English law after Brexit) to become designated under the SFD.<sup>2</sup>

It is therefore important to ensure that after Brexit, systems that are not governed by English law (including systems that are governed by the laws of a Member State, other than English law) will be able to benefit from the protections of the SFRegs in the UK, so that financial institutions in the UK will be able to continue to safely participate in such systems. This goal may be achieved by:

---

<sup>2</sup> As noted above, the CLS System is also designated, recognized or otherwise protected in numerous other jurisdictions that have implemented robust finality legislation for payment and settlement systems; if any of these jurisdictions had implemented a similar requirement to the effect that the law of the designating jurisdiction must govern the system, then CLS (and other systems located outside these countries) would not be protected by the legislation in these jurisdictions and it is highly unlikely that CLS could have participants from these jurisdictions or settle the currencies of these jurisdictions.

- (i) amending the SFRegs to eliminate the requirement that only systems that are governed by the law of England and Wales, Northern Ireland or Scotland may be designated under the SFRegs; this approach would align with the approach taken by many other jurisdictions that have adopted finality legislation to protect systemically important systems and their participants; and/or
- (ii) amending the SFRegs by implementing Recital 7 of the SFD, which provides that “Member States may apply the provisions of this Directive to their domestic institutions which participate directly in third country systems and to collateral security provided in connection with participation in such systems.” Various other European jurisdictions have already taken this approach, including Belgium, Germany, and Spain.

Please do not hesitate to contact us if you have any questions regarding this submission. We would be pleased to discuss these points in additional detail.

Sincerely,



Gaynor Wood  
General Counsel