Alan Marquard
Group General Counsel

CLS Group

Exchange Tower
One Harbour Exchange Square
London E14 9GE

Tel: +44 (0)20 7971 5409
Fax: +44 (0)20 7971 5729
amarquard@cls-group.com

July 21, 2015

Via email

Prudential Policy Department
Monetary Authority of Singapore
10 Shenton Way, MAS Building
Singapore 079117
Fax: (65) 62203973
Email: policy@mas.gov.sg

Re: Consultation Paper on Proposed Enhancements to Resolution Regime for Financial Institutions in Singapore

Ladies and Gentlemen:

CLS Bank International ("**CLS**"), the operator of the CLS settlement system (the "**CLS System**"), appreciates the opportunity to respond to the Consultation Paper on Proposed Enhancements to Resolution Regime for Financial Institutions in Singapore (the "**Consultation Paper**"), dated June 2015.

Background

CLS is a special purpose corporation organized under the laws of the United States of America and supervised by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York. CLS is also subject to cooperative oversight by 22 central banks whose currencies are settled in the CLS System, including the Monetary Authority of Singapore ("**MAS**"), pursuant to a Protocol for the Cooperative Oversight Arrangement of CLS[1] organized and administered by the Federal Reserve. The CLS System is a designated system in Singapore for the purposes of the Payment and Settlement Systems (Finality and Netting) Act (Cap 231, 2003 Ed) (the "**Payment and Settlement Systems Act**").[2]

The CLS System is a global settlement system that offers its members and their customers the ability to mitigate settlement risk with regard to their foreign exchange transactions. The CLS System relies on the protection provided by the Payment and

[1] http://www.federalreserve.gov/paymentsystems/files/cls_protocol.pdf

[2] CLS has also been designated under finality legislation in various other jurisdictions and has been designated a systemically important Financial Market Utility by the United States Financial Stability Council under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Settlement Systems Act to ensure finality of settlement and funding as well as enforceability of its netting and default arrangements. In this manner CLS ensures that it has an acceptable legal basis for its settlement of Singapore dollar payment instructions and for the participation of Singapore institutions as CLS members. As a financial market infrastructure (an "**FMI**"), the CLS System currently observes the applicable principles of the CPMI[3]-IOSCO Principles for financial market infrastructures (the "**PFMI**"), including Principle 1: Legal Basis ("An FMI should have a well-founded, clear, transparent, and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions").

CLS's Comments

- **Ensuring continuity of essential services and functions**

The Consultation Paper proposes to introduce powers to suspend the termination rights of non-financial contracts between financial institutions and their service providers, or to require these contracts to continue to be performed on the same terms and conditions that were in place prior to the resolution of the financial institution. As discussed in paragraph 5.1 of the Consultation Paper, a disruption of "essential services required by the financial institution to perform critical functions" could result from an exercise of termination rights triggered by the financial institution's entry into resolution.

- **Question 5: MAS seeks feedback on the proposal to introduce powers to ensure continuity of essential services and functions by suspending the termination rights of non-financial contracts, or requiring these contracts to be performed on the same terms and conditions that were in place prior to the resolution. Views are invited, in particular, on – (a) the scope of non-financial contracts to be subject to such powers; and (b) the potential implications on existing and future non-financial contracts.**

FMIs' role in the resolution of financial institutions

CLS supports and seeks to accommodate the regulatory goals expressed in paragraph 5.2 of the Consultation Paper, which provides that Singapore resolution authorities should have powers to ensure continuity of essential services and functions provided to an entity in resolution, any successor or any acquiring entity. Although it is unclear from the Consultation Paper whether a contract between a financial institution and an FMI would fall within the scope of these powers, in light of the fact that an FMI's failure to allow an entity subject to resolution (including a bridge institution or other successor entity) to participate in an FMI would likely disrupt these essential services, CLS believes that it is imperative for all FMIs to cooperate fully with regulators (including resolution authorities) to identify and address all issues that may impede continued participation.[4] However, payment systems, such as CLS, must observe

[3] Effective September 1, 2014, the Committee on Payment and Settlement Systems changed its name to the Committee on Payments and Market Infrastructures ("**CPMI**").

[4] Depending upon the specific FMI, its structure and the services it provides, this may also require that the FMI amend its rules, as necessary and appropriate, and facilitate a fast-track application process for successor entities, including bridge institutions.

relevant principles of the PFMI at all times and therefore cannot (and should not) allow continued participation of an entity subject to resolution where continued participation would compromise the continued safe and orderly operations of the FMI.[5]

In respect of a transfer of FMI membership to bridge institutions or other successor entities, CLS has identified, and has shared with regulators and its members, a lengthy list of issues that must be addressed in order to maximize the likelihood of a successful, timely transfer of CLS membership. These issues relate to a wide range of challenging legal, risk, operational (including the need for timely transfer of Business Identifier Codes (BICs)), and liquidity related requirements, which require international coordination. One key issue worth highlighting relates to the importance of ensuring that the successor entity has access to nostro arrangements in relevant jurisdictions. In order to participate in the CLS system, which currently settles payment instructions in 17 eligible currencies; the CLS rules provide that members must be able to demonstrate that they can timely provide funding to CLS, in accordance with a pay-in schedule issued prior to each settlement session, *in all currencies in which that member submits payment instructions*. In order to allow the entity to participate in the CLS system, CLS would require sufficient assurance or evidence that such funding would timely take place in all relevant jurisdictions.[6]

In light of the complexity of the issues involved (including operational and funding issues), significant advance planning and consideration is required. CLS believes that receipt of prior notice by system operators will maximize the likelihood of continued participation in the FMI by the institution or any bridge bank or other successor institution to which the entity's business is transferred as part of a resolution proceeding.

Resolution regime applicable to FMIs

CLS notes that some FMIs may use vendors that are critical to the performance of their service, and therefore such third party's refusal to provide services would affect the financial community at large. Thus, CLS supports affording Singapore resolution authorities the flexibility to ensure the continued performance by third parties under their existing agreements with FMIs, assuming the FMI also continues to perform under such agreements.

As an international system designated under the Payment and Settlement Systems Act but organized and operated outside Singapore and subject to primary supervision outside Singapore, CLS believes that the scope of the Singapore resolution regime should be tailored to extend only as far as necessary to enable regulatory authorities to take action in cooperation and coordination with the FMI's primary regulator outside Singapore to ensure the continued service of the FMI. CLS therefore suggests that Singapore authorities consider adopting a

---

[5] Please refer to Appendix II, Annex 1 to the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions, dated October 15, 2014, relating to resolution of FMI participants, which provides that "[j]urisdictions should ensure that laws and regulations applicable to FMIs should not prevent FMIs from maintaining the participation of a firm in resolution *provided that the safe and orderly operation of the FMI is not compromised*." [Emphasis added]

[6] Each FMI will likely have its own specific list of issues that must be considered and addressed in advance to ensure a successful outcome.

limited approach for foreign systems designated under the Payment and Settlement Systems Act, which would allow Singapore authorities to take appropriate steps to maximize the likelihood that designated systems will continue to provide their critical services. In order to accomplish this goal, the Singapore authorities' powers should include (i) powers to enforce contractual terms notwithstanding clauses for termination upon resolution; and (ii) stays to protect the FMI's assets that are used for its systemically important function, wherever held.[7]

- **Statutory bail-in regime**

The Consultation Paper proposes to introduce a statutory bail-in regime to complement the resolution toolkit for dealing with distressed financial institutions. The proposed scope of bail-in would exclude liabilities such as secured liabilities, short-term liabilities owed to financial institutions and payment systems (including the operators, settlement institutions and participants of the systems, since the repayment of liabilities to these entities is "necessary to ensure the continuity of essential services"), amounts owed to vendors for goods and services that are critical to the affected bank's operations, senior debt and all deposits.

- **Question 6: MAS seeks views on the proposal to introduce statutory bail-in powers under the MAS Act and for the bail-in powers to be first applied to Singapore-incorporated banks and bank holding companies.**

FMIs' role in the resolution of financial institutions

CLS supports the proposal to exclude short-term liabilities owed to payment systems, including the operators, settlement institutions and participants of the systems. However, CLS has concerns that a limitation on the maturity of excluded liabilities could result in bail-in of liabilities to payment systems even though their repayment is necessary to ensure the continuity of essential services, and giving rise to a "widespread and disruptive contagion to other parts of the financial system."[8] Therefore, CLS believes that the exclusion of liabilities owed to payment systems from bail-in should be maximized to ensure that the continued safe and orderly operations of the payment system is not compromised and the system is able provide its critical services without disruption.

Resolution regime applicable to FMIs

In an FMI resolution scenario, CLS believes that any legislation providing for bail-in should clearly provide that bail-in powers will not extend to, or impact upon, an FMI's default arrangements set forth in its rules, such as its access to liquidity providers. Access to liquidity providers in certain situations, pursuant to CLS's rules, is fundamental to the risk design of the CLS System and cannot be called into question. Banks may be reluctant to timely honor their obligations as liquidity providers or to agree to become liquidity providers (or to otherwise play

[7] The principle of "no creditor worse off" should apply notwithstanding such stays, however, protections from creditor actions for an appropriate time period may be necessary to maintain market confidence while the resolution authorities resolve the FMI in an orderly way to prevent systemic disruption.

[8] Paragraph 6.5 of the Consultation Paper.

an important role with respect to an FMI's default arrangements) if they have reason to doubt repayment from the FMI.

- **Cross-border recognition of resolution actions**

The Consultation Paper states that given the cross-border nature of the financial institutions operating in Singapore, Singapore's resolution framework should enable a cooperative solution to be reached with foreign resolution authorities. CLS supports MAS's evaluation of a recognition process "to take supportive measures to achieve a cooperative solution with foreign resolution authorities in a group-wide resolution of cross-border financial institutions."[9]

- **Question 11(b): MAS seeks views on – (b) the scenarios where a foreign resolution action may not be in the interest of a local branch or subsidiary of a foreign financial institution, which MAS would need to take into consideration when deciding if it should recognize or support the foreign resolution action.**

FMIs' role in the resolution of financial institutions

In order to maximize the likelihood of a successful resolution and to minimize systemic disruption, CLS suggests that MAS consider the need for amendments to the Payment and Settlement System Act to ensure that statutory protections (e.g. finality and netting) for systems designated under that act apply in a resolution scenario, and continue over the course of the resolution strategy or use of the relevant resolution tool. In addition, and for the sake of consistency, CLS suggests that the Payment and Settlement Systems Act should be amended to provide that protections under the Payment and Settlement Systems Act will not terminate after an insolvency (or, at a minimum, only terminate upon the commencement of a liquidation with respect to the participant's head or home office), but will continue at all times (including upon and after insolvency).

- **Resolution funding**

As discussed in paragraph 9.1 of the Consultation Paper, for the successful and orderly resolution of a financial institution that is systemically important or that maintains critical functions, it is important to establish resolution funding arrangements to ensure timely access to funds. In respect of capital market infrastructures and DPS[10] operators, the Consultation Paper proposes an ex post recovery mechanism in resolving capital market infrastructures or DPS operators.

- **Question 21: MAS seeks views on the scope of ex post recovery, i.e. the scope of entities from which costs should be recovered. In the case of a DPS operator,**

[9] Paragraph 7.8 of the Consultation Paper.

[10] As described in the Consultation Paper, "**DPS**" refers to a payment system considered to be of systemic or system-wide importance and which have been designated pursuant to the Payment Systems (Oversight) Act (Cap. 222A of Singapore) (the "**Oversight Act**"). By letter dated August 5, 2006, pursuant to section 53(2) of the Oversight Act, MAS exempted the CLS System and CLS from certain sections of the Oversight Act.

MAS seeks views on the recovery of funds from all direct and indirect participants of the resolved DPS operator.

- **<u>Question 22</u>: MAS seeks views on the manner by which costs should be recovered, for example, whether this may be through levies on participants or transaction levies, and the apportionment of such levels.**

<u>Resolution regime applicable to FMIs</u>

Resolution funding arrangements applicable to FMIs must take into account that some FMIs, such as the CLS System, are international in scope. For such FMIs, any resolution funding arrangement should: (i) only be triggered in cooperation and coordination with the FMI's primary regulators in the jurisdiction of the FMI's operator and under no circumstances be commenced without notifying the FMI and its primary regulators in advance, and (ii) contain clear triggers that are consistent across jurisdictions (and global authorities should coordinate the establishment of such triggers), so that recovery measures will not be inadvertently disrupted. Due to the above-cited complexities, resolution funding arrangements for FMIs require unique consideration and, in certain cases, require international coordination, in order for an FMI in resolution to maintain the confidence of its participants and thereby provide its critical services without disruption.

In addition, CLS notes that for the sake of transparency and fairness, FMIs commonly operate pursuant to rules and participant agreements that underpin the services they provide. The right to allocate losses in the CLS System is governed by its rules, which form part of its contractual agreement with its participants. Therefore, participants subject to loss allocation should be treated as contractual counterparties or, if applicable, creditors, and as such should be treated in the same manner as other similarly ranked creditors. In order to ensure the continuity of an FMI's services in resolution, it is imperative that any resolution regime or authority respect the rules or other contractual relationships between the FMI and its participants in all circumstances (before, during and after a resolution). In an FMI resolution scenario, participants should otherwise not be subject to losses unless such losses are controllable and pursuant to ex ante arrangements.

Please do not hesitate to contact us if you have any questions regarding this letter.

Yours sincerely,

Alan Marquard

cc: Dino Kos, Head of Global Regulatory Affairs
Lauren Alter-Baumann, Legal and Regulatory Strategic Affairs
Elise Kim, Assistant General Counsel