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Via Email: www.esma.europa.eu

Re: CLS Bank International Response to ESMA's February 16, 2012 Discussion Paper with respect to Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories (the "ESMA Discussion Paper")

Ladies and Gentlemen:

We are writing in response to the ESMA Discussion Paper. Thank you for the opportunity to submit these 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. CLS Bank's payment-versus-payment settlement service is the predominant settlement system for foreign exchange globally. CLS Bank 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. 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.

Our comments, set forth below, relate to: (1) "Criteria to be assessed by ESMA under the clearing obligation procedure" and "Q7: What are your views regarding the specifications for assessing standardisation, volume and liquidity, and availability of pricing information?"; and (2) the need for detailed communications to relevant stakeholders after ESMA renders a "negative assessment" decision with respect to a clearing obligation (which is not currently addressed in the draft technical standards).

1. Criteria to be assessed by ESMA under the Clearing Obligation Procedure and Q7

Paragraph 21 of the ESMA Discussion Paper provides that "ESMA shall take into consideration criteria defined in EMIR, i.e. the degree of standardisation of the relevant class of OTC derivatives' contractual terms and operational processes, the volume and the liquidity of the relevant contracts within the relevant class of derivatives and the



availability of pricing information." Paragraph 22 sets forth the factors that ESMA should consider in assessing these criteria (e.g., standardization of contractual terms, margins, and accessibility of pricing information).

We note, however, that the current draft technical standards do not refer to the following key guiding principles set forth in EMIR relating to whether or not a class of derivatives will be subject to a clearing obligation:

- Systemic Risk - draft regulatory technical standards are to be prepared "with an overarching aim of reducing systemic risk" (Article 4(4) of EMIR);
- Market features – "[D]ue account should be taken of the specific nature of the relevant classes of OTC derivatives. The predominant risk for transactions in some classes of OTC derivatives may relate to settlement risk, which is addressed through separate infrastructure arrangements, and may distinguish certain classes (e.g. foreign exchanges) of OTC derivatives from other classes. CCP clearing specifically addresses counterparty risk, and may not be the optimal solution for dealing with settlement risk." (Recital 12(c) of EMIR); and
- International convergence – "The regime for such contracts should rely notably on preliminary international convergence and mutual recognition of the relevant infrastructure." (Recital 12(c) of EMIR).

For the reasons described below, CLS Bank fully supports these EMIR principles and submits that these principles should be reflected in the draft technical standards, in order to ensure that they are afforded sufficient consideration by ESMA in connection with any determination regarding the subjection of a class of OTC derivatives to clearing. Without such express recognition in the processes ESMA is seeking to design, there is no obvious basis on which the meaning of Recital 12(c) and wider systemic issues will be properly acknowledged going forward.

As Recital 12(c) suggests, foreign exchange transactions are different from other classes of derivative transactions and merit special consideration. Settlement risk in the context of foreign exchange transactions is the risk of paying out sold currency without receiving the purchased currency in return. Having such exposure for even a short time can be significant, particularly when (as is often the case) such amounts represent a large portion of a party's capital. Accordingly, the risk profile of foreign exchange swaps and forwards (and foreign exchange spot transactions outside the scope of EMIR), is concentrated on settlement risk, not counterparty credit risk, so foreign exchange transactions are unlike those involving other derivatives. Foreign exchange swaps and forwards have fixed, predetermined payment obligations, and require the exchange of the full principal amount in two different currencies (as opposed to a one-way payment based on incremental profit and loss). This physical settlement requirement mitigates, for foreign exchange swaps and forwards, the counterparty credit risk found in most other derivatives.



The importance of international convergence has been widely acknowledged. As IOSCO's February 2012 "Requirements for Mandatory Clearing" paper (the "February IOSCO Paper") states "[D]etermining authorities should generally seek to coordinate with each other in developing and implementing a mandatory clearing obligation in order to ensure consistency of approach wherever possible. This is also true in the context of exemptions, where disparity in the scope of exemptions across jurisdictions could enable certain counterparties to avoid the requirements of one jurisdiction by transacting in another and, in that way, avoid clearing its transactions altogether where exemptions are based upon the location of transactions." We note that on April 29, 2011, the U.S. Department of the Treasury issued a proposed determination to exempt foreign exchange swaps and forwards from the definition of "swap" under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which would result in those transactions not being subject to any mandatory clearing requirement (among other things) under Dodd-Frank. Since then, various other major jurisdictions such as Australia, Singapore and Hong Kong have either proposed similar exemptions for foreign exchange swaps and forwards or have indicated that they expect to follow a similar approach.

2. Communication of a "negative assessment" decision to all relevant stakeholders

In order to provide as much certainty as possible to the market with respect to the scope of any decision by ESMA regarding whether the clearing obligation should be applied to a particular class of OTC derivatives, we suggest that the draft technical standards should state that such determination, whether negative or positive, should be made freely and publicly available (i.e., on the ESMA website) in order to offer as much clarity as possible as to whether a clearing obligation does or does not apply and the applicable time frame, if appropriate (see the February IOSCO Paper). In addition, where a negative determination is made on the basis of the principles set forth in Recital 12(c), the determination and underlying reasoning should also be made publicly available. In this way, a body of guidance will develop regarding ESMA's practical approach when determining whether a clearing obligation should apply.

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

Sincerely,

A handwritten signature in black ink, appearing to read 'Alan G. Bozian'. The signature is fluid and cursive, with the first name 'Alan' being particularly prominent.

Alan G. Bozian

cc: James P. Holdcroft, EVP and Chief Legal Officer, CLS Bank International
Lauren Alter-Baumann, Associate General Counsel, CLS Bank International