Introduction to CLS

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www.cls-group.com

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CLS seeks to be the leading provider of risk mitigation and operational services to the global foreign exchange market
About CLS
About CLS

- Created as a result of regulatory concern regarding the potential for FX settlement risk to be a major source of systemic risk
- Provides settlement services for FX spot, FX forwards, and FX swaps in 17 currencies:
  - Directly to 62 settlement members; and
  - Indirectly to their 18,000 clients
- Settles approximately USD5 trillion of gross FX payment instructions daily
- Unique oversight framework: regulated by the Federal Reserve; Oversight Committee of 22 central banks
- Designated as a Systemically Important Financial Market Utility (Financial Stability Oversight Council)
- Recognized as being a contributing factor to the US Department of the Treasury’s determination that FX swaps and FX forwards would be exempt from the central clearing and trading requirements of Dodd-Frank
Our services

- Our **core settlement service** settles payment instructions for FX spot, FX forwards, and FX swaps.

- **USD/CAD same-day settlement** allows members to execute and settle same-day trades within an additional settlement session.

- Trade compression service through **CLS Aggregation Services** which reduces the operational risk and costs associated with high-frequency trading.

- **In/out swap service** reduces the payment obligations to CLS and mitigates liquidity pressures.

- Settlement of certain CDS transactions on behalf of DTCC.
The numbers

- **Average daily volumes submitted:**
  - **circa 1.2 million instructions**
  - Settlement service input: 800,000
  - Aggregation input: 400,000

- **Average daily values settled:**
  - **USD5.1 trillion**
  - Multilateral netting reduces the funding required to settle this amount to less than USD50 billion a day

- **Record daily volume and settled value:**
  - **Volume:** 2,258,192 sides (20 Jan 2015)
  - **Value:** USD10.67 trillion (17 Dec 2014 – quarterly IMM settlement date)

- **Participation**
  - 76 shareholders
  - 62 settlement members

- **26 settlement members** provide settlement services to approximately 18,000 third parties

- **Third party business** accounts for approximately 22% of the total value settled

Source: CLS, October 2014
Evolution of CLS

Pre-CLS (2002)

Settlement risk drivers

- Liquidity constraints
- Operational risk – FX trades settled as two individual transactions
- Commercial banks

Settlement risk mitigants

- Multilateral netting
- Payment-vs-payment settlement with finality
- RTGS system per currency (real time) – aligned operating hours to create CLS settlement session

FX settlement risk

Different time zones for each currency
Batch process
The CLS ecosystem

CLS is subject to regulation and supervision by the Federal Reserve as well as cooperative oversight by the CLS Oversight Committee (OC) which includes the 17 central banks of CLS-settled currencies as well as five other Eurosystem banks.
Risk mitigation challenges

- Manage credit risk
- Mitigate gross FX settlement risk across:
  - Own funds
  - Institutional mandates
- Manage operational risk and efficiencies
  - Reduce fails in FX to ensure securities settlement
  - Cash management across the full working day and after-hours
  - Multiple global custodians
The CLS solution

Operational risk and efficiencies

- FX industry best practice
- SWIFT standards for messaging
- Matching and settlement
  - Trade date settlement instruction matching on average within 20 minutes
  - Real-time reporting trade status to global custodian
  - Lower risk of securities settlement failure due to higher confidence in payment-versus-payment funding
  - High level STP from trade execution through to matching and settlement
- Lower processing costs
  - Reduced cash management resource overheads
  - Significantly reduced investigations and interest claims
  - Reduction in message repairs
How CLS works
How CLS works

- CLS maintains accounts with all 17 central banks of the currencies settled, with access to the relevant real time gross settlement (RTGS) systems
- Settlement members each have a multicurrency account with CLS
- Funding and pay-out of multilateral net positions is conducted using a daily, defined schedule
- Settlement members pay and receive funds through CLS’s central bank account in each currency via their own accounts or nostro bank accounts
- On each settlement date, CLS simultaneously settles each pair of matched instructions, subject to satisfying three risk management tests
- The settlement of the payment instructions and the associated payments are final and irrevocable. Finality is one of the most important elements of the CLS system
- Settlement members offer CLS access to their own customers (CLS third parties)
Operational timeline – core settlement service (CET)

- **20:00 – 20:45** Credit derivatives (DTCC) cash flow submission window for next settlement day
- **00:00** Bilateral rescind deadline
- **00:00** Revised pay-in schedule issued. Central bank Pay-in report issued
- **07:00** Settlement completion target time (pay-in)
- **10:00** Asia Pacific funding completion target time (pay-in)
- **12:00** European/ North American funding completion target time (pay-in)

**Instruction input and matching**

- **01:15** In/Out swap details available to members
- **06:00 – 07:00** RTGS system handshakes

**Settlement**

**Completion of pay-in / pay-out process**

**Pay-ins / pay-outs**
Multilateral netting

* Peak day:
  • 17 December 2014, CLS settled a record of USD10.67 trillion in gross value
  • Net funding was USD57 billion; a netting efficiency of 99.5%
Third parties in CLS

- CLS provides settlement services to its members and their customers:
  - Directly to members
  - Indirectly to third parties – members providing third party access to their customers
- Third parties include banks, nonbank financial institutions, multinational corporates and funds
- Third parties have no contractual relationship with CLS
  - Members handle all payment instructions and funding on behalf of their third party customers
- Available to the investment management community including:
  - Investment managers
  - Hedge funds
  - Pension funds
  - Sovereign wealth funds
Third party activity

- Third party activity accounts for approximately 22% of the total value and 16% of the total volume settled in CLS.

Third parties by value:
- Banks: 56%
- Funds: 35%
- Corporates: 2%
- Non-bank financial institutions: 7%

Third parties by number of participants:
- Funds: 97.4%
- Banks: 1.9%
- Corporates: 0.3%
- Non-bank financial institutions: 0.4%

Source: CLS (third party BICs) and funds settled through CLS in 2014 (Jan – Dec 2014)
About CLS’s corporate governance
Each of the CLS Group legal entities is subject to the provisions contained in its constitutional documents, as well as applicable laws and governance codes.
CLS corporate governance

○ CLS Group ownership
- 76 shareholders with global distribution
  - Voting rights limited to 100 votes per shareholder / affiliated shareholder group

○ CLS Group and CLS Bank Boards – 22 directors
- Sixteen Shareholder Representative Directors
- Five Outside (Independent) Directors, one of whom is Chairman of the Board
- One Executive Director who is the CEO

○ Duties of the Board of Directors are described in the CLS Group Articles of Association, its Organizational Regulations and applicable laws and governance codes
- Supervision, oversight and strategy
- Governance and compliance
- Fiduciary duty to CLS Group
CLS Group executive management

Chairman

CEO

Chief Financial Officer

Chief Human Resources Officer

General Counsel

Chief Compliance Officer

Head of Regulatory Affairs

Chief Internal Auditor

Core Functions

Support Functions

Chief Information Officer

Chief Risk Officer

Head of Global Operations and Relationship Management

Head of Asia
Interaction between board committees and management

** Member of the Executive Management Team
** Chairs Committee is also the Compliance Committee
# Oversight Rulebook is reconsidered
Regulatory oversight and stakeholder input

- **Regulatory oversight**
  - CLS’s oversight framework: regulated by the Federal Reserve; Oversight Committee of 22 central banks
  - In addition, CLS, as a systemically important financial market infrastructure, is subject to the oversight and provisions by other market regulators, such as BIS and CPMI-IOSCO.

- **Inclusion of stakeholders**
  - CLS regularly engages with its shareholders
  - CLS regularly engages with its settlement members and liquidity providers, including, but not limited to, consultation processes for proposed changes to the CLS Bank Rule Book
  - CLS regularly engages with central banks (including exploration of additional currencies)
  - CLS participates in the public consultation process by providing comments on proposals published by regulatory entities in various jurisdictions
Current CLS initiatives
Expanding currency footprint

- 17 currencies settled in CLS
- Objective to expand
  - Core mission of CLS – mitigation of settlement and systemic risks
  - Extend reach to include more emerging market currencies
- Working to add Hungarian forint in November 2015
- Governance structure:
  - Board of Directors
    - Strategy Committee
    - Provide overall direction and guidance
    - Approval by Risk Committee and full Board
  - Member working group
  - Regulatory oversight and approval
Same Day Settlement

- CLS’s initial product set at go-live included FX spot, forwards, and swaps
- Post crisis: objective to add trades that settle the same day
  - Reduce settlement risks in the system
- Technology and operational challenges
- Live in September 2013 for USD/CAD (“Americas Session”)
- Seek to add MXN in 2016
- Exploring Atlantic Session for SDS in European time zone
- Governance structure:
  - Board of Directors
    > Strategy and Risk Management Committees of the full Board
    > Provide overall direction and guidance
  - Member working group
  - Regulatory oversight and approval
Cross currency interest rate swaps

- Cross currency interest rate swaps ("CCS") not included in initial product set when CLS went live
- Add more products to expand the number and type of transactions that settle with payment-versus-payment
- Working to go live with settlement of initial and final principal exchanges of a cross currency interest rate swap
  - Will not settle intermediate cash flows during life of the swap
- Governance structure:
  - Board of Directors
    - Strategy Committee of the full Board
    - Provide overall direction and guidance
  - Working group with initial group of banks
  - Regulatory oversight and approval
FX compression

- Compression of trades (also called “tear-ups”) has been used in derivative markets for years
  - Interest rate swaps and credit default swaps
  - Reduce the outstanding number of trades while keeping the economic value unchanged
  - Reduce gross exposures and reduce capital requirements
- Working with another firm to offer compression services
  - CLS to provide trade info/data – other firm to run process of compression
  - Aiming to go live in second half of 2015
- Governance structure:
  - Board of Directors
    - Strategy Committee of the full Board
    - Provide overall direction and guidance
  - Working group with initial group of banks
  - Regulatory oversight and approval
CCP services

- **Background:**
  - Industry seeking to find a clearing solution for FX options
  - Threshold challenge has been to solve settlement risk in a scenario where a major counterparty fails
  - CCPs and banks have worked with CLS and industry groups to find a solution
- **Exploring various options including:**
  - Under one scenario, CLS to provide a separate CCP session that would leverage CLS accounts at central banks to settle obligations of clearing members and CCP
  - CCP would maintain responsibility for default management
- **Working with CCPs to gauge demand for such a service**
- **Goal:** mitigate settlement risk and foster financial stability
- **Governance:**
  - Board of Directors
    - > Strategy Committee
  - Industry groups, Clearing Members
  - Regulators and central banks
Other initiatives

- Enhanced liquidity framework
  - Make CLS and ecosystem more resilient
  - Risk Committee

- Technology upgrade
  - Enhance technical resiliency
    > Including cyber security
  - Assure safe and efficient settlement every day
  - Technology and Operations Committee

- Sustainable financial model
  - Capital raise in 2013
  - Establish principles for how the company will be managed
  - Audit and Finance Committee

- Full Board of Directors engaged in all aspects
Overall governance:

CLS vision

strategy

initiatives

implementation