



IOSCO-CONFYN 2012  
Financial Stability  
in a Period of Volatility

Gerard Hartsink  
Chairman of the Board  
November 2012

[www.cls-group.com](http://www.cls-group.com)



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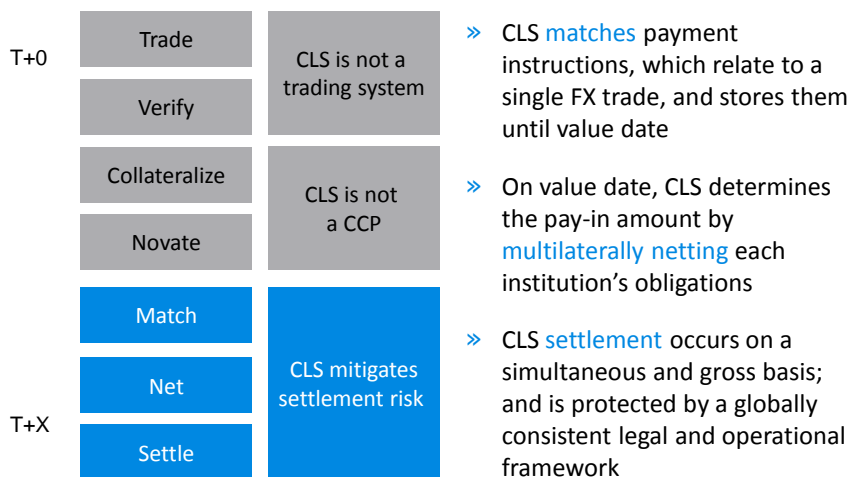
CLS Mission Statement



***To enhance financial stability by  
providing risk mitigation services to the  
global FX market***



## How CLS helps mitigate risk during a trade cycle



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## What is settlement risk?



- Settlement risk is the probability of loss of principal arising from failure of one counterparty to settle its end of the trade
- Settlement risk is sometimes referred to as “Herstatt risk”, after the failure of German bank Bankhaus Herstatt (1974)
- Failure by one party to settle its side of the deal could start a chain reaction of cross defaults – systemic risk
- Widely recognized as the most significant systemic risk in FX
- One way to mitigate settlement exposure is to settle both transactions payment-versus-payment (PvP), simultaneously using central bank funds under appropriate finality legislation

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## The Allsopp Report's key recommendations (1996)



- For central banks
  - Improve settlement practices
  - Encourage banks to fully quantify FX settlement risk exposures
  - Support a well-founded legal framework
  - Encourage increased correspondent banking competition
- For commercial banks
  - Measure FX settlement exposures properly
  - Apply appropriate credit control to FX settlement exposures
  - Reduce excessive FX exposures for a given level of trading
- For industry groups
  - Develop well-constructed and and soundly based multi-currency services to contribute risk reduction efforts
- All G10 currencies are now CLS, but not all G20's



## CLS today



Launched in 2002, CLS is the world's largest multicurrency settlement system

CLS mitigates FX risk in 17 currencies by settling both legs on a PvP basis on accounts held at central banks

In 2012, CLS estimates it will:

- settle transactions averaging USD 4.5 trillion daily (historic peak, USD 10.3 T in 2008)
- process close to 690,000 instructions per day
- maintain the 96% in liquidity savings achieved YTD



## CLS and Chile



CLS expects to double the number of currencies it settles over the next 10 years and considers the Chilean peso a high priority.

CLS looks forward to continue to work closely with Banco Central de Chile, Ministry of Finance, FX banks and banking association.



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## CLS Currency Program



### EXISTING CLS CURRENCIES

USD CAD MXN - DKK NOK SEK GBP EUR CHF - ZAR - ILS - JPY KRW HKD SGD AUD NZD



### TARGET CLS CURRENCIES

BRL CLP COP PEN - RUB CZK HRK HUF PLN RON TRY - AED SAR - CNY IDR INR MYR PHP THB



## CLS currencies and regulatory oversight



- Overseen by the **CLS Oversight Committee**
  - Formal cooperative oversight arrangement established by central banks (22) whose currencies (17) are settled in CLS



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## New and existing currencies must meet same standards

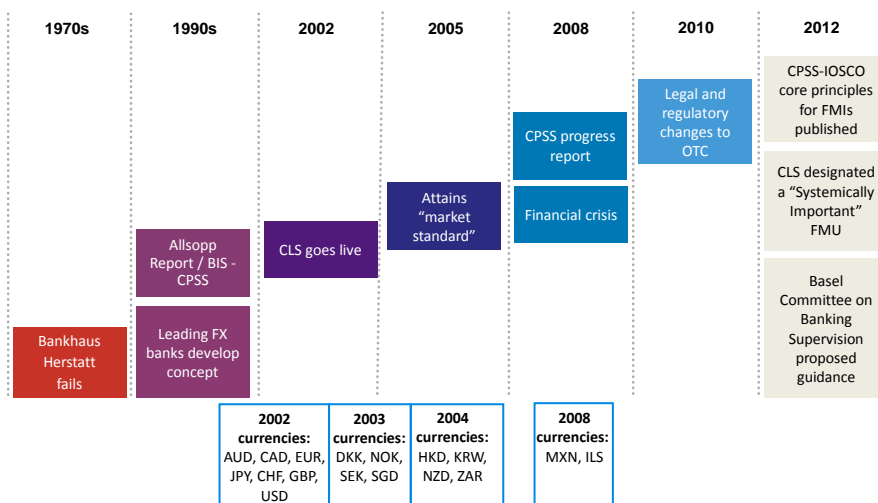


Requirement	Main aspects
<b>Sovereign Credit Rating</b>	» Minimum of BB- / Ba3
<b>Legal</b>	» Finality of payments and settlement » Unity of multi-currency account » Adequate Anti-Money Laundering regime
<b>Currency</b>	» Sufficient convertibility » Acceptable exchange controls for CLS operation
<b>Domestic Support</b>	» Strong commitment from central bank » Three Liquidity Providers
<b>Operational</b>	» RTGS system can make pay-ins by cut-offs » RTGS system messages are SWIFT compliant » CLS account at the central bank

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## CLS and Evolution of Settlement Risk Standards



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## CLS' successful FX settlement risk mitigation platform



CLS' success in mitigating settlement risk in FX transactions continues to be widely recognized:

- Proposed supervisory guidance issued in August 2012 by the Basel Committee on Banking Supervision
  - Acknowledges Pvp's part in FX risk reduction since 2000 report
  - Supports additional currencies, products and counterparties in PVPs
  - Recommends banks ensure sufficient capital is held against FX exposures
- The settlement risk mitigants provided by CLS partly account for the exemption of FX swaps and forwards from central clearing requirements by the US Treasury



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## CLS, FX market and global regulation



In its recent comments on global regulation, CLS has emphasized:

- the predominant risk in FX transactions is settlement risk
- FX settlement risk is voluntarily and effectively mitigated by participation in CLS

Key outstanding regulatory issues for 2013 include:

- Exemption for FX swaps and forwards from central clearing requirement from European regulators (ESMA)
- Margin requirements for Non-Centrally Cleared Derivatives
- Global harmonization of final rules



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## Q & A



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## Other key regulatory events for 2013



- CPSS-IOSCO's "Principles for Financial Market Infrastructures"
- Federal Reserve proposes risk-based capital, in line with Basel III
- G20 summit approves Financial Stability Board recommendations for Legal Entity Identifier
- CFTC issues cross-border guidance, sparking responses on extraterritoriality concerns from regulators around the world
- European regulators publish technical standards on OTC derivatives, central counterparties and trade repositories
- European Commission proposes basis for EU Banking Union



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## Types of FX transactions



Product	Definition <sup>1</sup>	In CLS?
FX spot	The purchase or sale of one currency for another, with delivery usually taking place within two days after the dealing date	Yes
Outright Forwards	A contract to exchange a predetermined amount of one currency for another at an agreed date in the future, based upon a rate of exchange determined at the trade date of the contract	Yes
Non Deliverable Forwards (NDFs)	Similar to outright forward but there is no physical settlement of two currencies at maturity. Rather, based on the movement of two currencies, a net cash settlement will be made by one party to the other – usually in dollars	Yes
FX Swaps	A contract that simultaneously agrees to buy (sell) an amount of currency at an agreed rate and to resell (repurchase) the same amount of currency for a later value date to (from) the same counterparty, also at an agreed date	Yes
Currency Swaps	A swap where interest and principal in one currency are exchanged for interest and principal in another	No
FX Options	A contract that gives the buyer the right, but not the obligation, to exchange one currency for another at a predetermined exchange rate or until the maturity date	Yes



<sup>1</sup>Source: FXJSC paper on the foreign exchange paper, September 2009