

# **Protocol for the Cooperative Oversight Arrangement of CLS<sup>1</sup>**

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## **Introduction**

- 1) Whereas, CLS began operations in September 2002 using payment-versus-payment ("PVP") settlement to reduce the risk involved in settling obligations related to foreign exchange transactions,
- 2) Whereas, CLS has expanded its business model into non-PVP settlements since November 2007 when it was granted approval by the Federal Reserve for the settlement of non-PVP payment obligations related to a limited set of financial instruments (non-deliverable foreign exchange forwards, foreign exchange option premiums and over-the-counter credit derivatives),
- 3) Whereas, the G-10 and other central banks of issue of CLS-settled currencies (the "participating central banks") have a common interest in the prudent design and management of the settlement system operated by CLS (the "CLS system") given their shared public policy objectives for ensuring the safety and efficiency of payment and settlement systems in their respective currencies and their focus on the stability of the financial system,
- 4) Whereas, CLS Bank maintains an individual account relationship with each central bank of issue of CLS-settled currencies, and each central bank has the authority to impose conditions, to terminate or otherwise to limit CLS Bank's access to this account and any associated settlement services<sup>2</sup>,
- 5) Whereas, the Federal Reserve<sup>3</sup> charters, regulates, and supervises CLS Bank,
- 6) Whereas, each of the participating central banks may have additional responsibilities and authorities vis-à-vis CLS with regard to applicable laws, regulations and policies (including those related to payment and settlement infrastructures in the respective currency area), either now or in the future,
- 7) Whereas, each participating central bank maintains its discretion to discourage or to prohibit the use of CLS or the provision of services to CLS if, in its judgment, the system is not prudently designed or managed, or does not comply with applicable laws, regulations and policies,

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<sup>1</sup> In this document, "CLS" refers to the entire CLS organization which includes: (1) CLS Group Holdings, the group holding company incorporated under the laws of Switzerland and regulated by the Federal Reserve as a bank holding company in the United States; (2) CLS UK Intermediate Holdings, a limited company incorporated under the laws of England and Wales, a 'shell' company from a governance perspective providing corporate services (i.e., Finance, Human Resources, Audit and Communications) to CLS Bank and its affiliated companies; (3) CLS Bank, an Edge corporation organized under the laws of the United States and regulated by the Federal Reserve; and (4) CLS Services, a limited company incorporated under laws of England and Wales, which provides operational and back-office support to CLS Bank and its affiliated companies.

<sup>2</sup> As regard to the euro, CLS Bank maintains an account relationship with the European Central Bank only.

<sup>3</sup> Unless otherwise indicated, "Federal Reserve" refers to the Federal Reserve System, which includes both the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York, collectively.

- 8) Whereas CLS Bank signed a commitment letter, dated 17 September 2007, to all the participating central banks as of that date in relation to its request for approval to settle over-the-counter credit derivative transactions.

### **Establishment of a Cooperative Oversight Arrangement for CLS**

- 9) The participating central banks have established this cooperative oversight arrangement for CLS (the "Protocol") to provide a mechanism for mutual assistance in carrying out their individual responsibilities in pursuit of their shared public policy objectives for the safety and efficiency of payment and settlement systems and their focus on the stability of the financial system. In particular, the participating central banks seek to promote a consistent oversight approach that:
- A) Achieves comprehensive oversight of the overall CLS system;
  - B) Enhances oversight efficiency by minimizing burden on CLS and the duplication of effort by the participating central banks;
  - C) Fosters consistent and transparent central bank communications with CLS;
  - D) Fosters transparency among the participating central banks regarding the development and implementation of applicable policies; and
  - E) Supports fully informed judgments when participating central banks make their independent yet interdependent oversight assessments and decisions vis-à-vis CLS.
- 10) This cooperative oversight arrangement is established under the principles for international cooperative oversight contained in the CPSS report on "Central Bank Oversight of Payment and Settlement Systems."
- 11) The Principles for Financial Market Infrastructures ("PFMI") developed by the Committee on Payments and Markets Infrastructure and the International Organization of Securities Commissions, serve as minimum standards against which CLS is assessed by the participating central banks.
- A) Participating central banks reserve the right, when necessary and appropriate, to set requirements commensurate with the evolving systemic importance of CLS that exceed the minimum standards outlined in the PFMI.
  - B) CLS is also subject to individual central bank policies. The CLS oversight arrangement in no way prejudices or constrains the statutory or other responsibilities of the participating central banks, including regarding the application of laws, regulations and policies.
  - C) To avoid, where relevant and possible, inconsistencies in the oversight relationship with CLS, individual central banks should consult the other participating central banks, as necessary, before implementing policies or taking any action that could materially affect CLS. Because steps taken by one central bank with respect to CLS could have implications for the other participating central banks, this principle should, as far as possible, be interpreted broadly to cover any policy or action that has a material impact on CLS. The expectation is that individual central banks will conduct this consultation as timely as possible.

- 12) The participating central banks recognize that the responsibilities of CLS overseers are distinct from the responsibilities of CLS supervisors; at the same time, there is overlap in the interest of overseers and supervisors. The oversight and supervisory processes aim to inform and support each other with effective coordination and communication.
- 13) The participating central banks also cooperate in fulfillment of their respective operational roles and responsibilities in the CLS RTGS operators group, and they recognize that the oversight and operational processes aim to inform and support each other, where permitted and appropriate, with effective coordination and communication.

### **Key Elements Governing the Cooperative Oversight Arrangement**

#### ***Primary Responsibility and Coordination of CLS Oversight***

- 14) The Federal Reserve accepts primary responsibility for the oversight of CLS under this cooperative oversight framework.
  - A) The Federal Reserve's supervisory role and responsibility for CLS are distinct from and complement the Federal Reserve's oversight role and responsibility for CLS.
  - B) The Federal Reserve coordinates the cooperation between the participating central banks and the Federal Reserve supervisors.

#### ***Organization of the Cooperative Oversight Arrangement***

- 15) The Federal Reserve organizes and administers the CLS Oversight Committee ("OC"), which is the primary forum for the participating central banks to carry out their cooperative oversight of CLS.
  - A) The Federal Reserve provides the Chairperson and Secretariat for the OC.
    - The Chairperson is appointed by the Chairman of the Board of Governors of the Federal Reserve System.
  - B) Each participating central bank designates one responsible senior official ("RSO") to serve as the principal member of the OC and to ensure ongoing senior-level engagement and accountability on CLS oversight matters within each participating central bank.
    - The RSO is appointed by the Governor of the respective central bank.
    - Each RSO can name one or more designees, as appropriate and necessary.
- 16) The specific processes and procedures of the OC are documented in the CLS Oversight Guide, which may be modified, as necessary, subject to consensus by the RSOs.

#### ***Assessment of the Overall System***

- 17) The OC periodically assesses the design and operation of CLS against the PFMI.

- A) The OC may accomplish this by reviewing and commenting upon analyses and disclosures prepared by CLS, assessments prepared by the CLS supervisors, or independent analyses and assessments prepared by OC members.
    - Under current Federal Reserve Board regulation, CLS is required to prepare a comprehensive public disclosure at least every two years or when there is a material change (e.g., the addition of new currencies, major new services, and changes to CLS' operations and risk management procedures).
    - The supervisors assess CLS as required by Federal Reserve Board Regulation HH, which prescribes risk-management standards based on the PFMI. Using information derived from these ongoing supervisory activities, the supervisors continuously assess CLS' observance of the PFMI.
    - The Federal Reserve and the other participating central banks reserve the right to prepare their own independent analyses and assessments of CLS against the PFMI when they find it necessary to do so.
      - (1) Such assessments should be shared with the OC.
      - (2) All central bank assessments (including results and related reports) of CLS' observance of the PFMI are considered confidential unless the participating central banks agree otherwise (see paragraph 33).
  - B) The participating central banks strive to reach consensus on their assessment of CLS' observance of the PFMI.
  - C) The OC may incorporate supervisory insights, work, and information in preparing, reinforcing, and/or validating elements of their analyses and assessments (see paragraphs 28 - 29).
- 18) Each participating central bank is responsible for reviewing CLS' design and ongoing operations, as well as any proposed material changes, against any additional applicable laws, regulations and policies for which the participating central bank may have responsibilities or authorities vis-à-vis CLS. Each participating central bank can liaise and seek information directly from CLS in order to meet these requirements.

### ***Approval of Proposed New Currencies***

- 19) CLS must receive written approval from the Federal Reserve to settle any new currency.
- 20) As part of its review and approval process, the Federal Reserve will, without undue delay, consult with the participating central banks to identify and resolve any issues or concerns they may have with any proposed new currency.
  - A) The OC will analyze CLS' continued observance of the PFMI with regard to proposed new currencies. In particular, the participating central banks will review the potential liquidity impact of the proposed currency on their respective currencies.
- 21) The Federal Reserve will not approve a request by CLS to settle any new currency whose central bank of issue objects to its inclusion.

- A) Based on its view of the overall system under the PFMI and its determination of the adequacy of CLS' settlement and failure-to-settle procedures in its currency, the central bank of issue of the proposed new currency will be asked to provide formal notice to the Federal Reserve whether it objects or does not object to the inclusion of its individual currency in CLS.
- B) The other participating central banks will not be asked to provide formal notice to the Federal Reserve whether they object or do not object to the inclusion of the proposed new currency.

### ***Review of Other CLS Proposals***

- 22) CLS must provide the Federal Reserve Board at least 60-days advance notice of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by CLS.
- 23) Following receipt of such notice, the Federal Reserve will, without undue delay, inform the OC of such proposals for the purpose of identifying and seeking consensus among the OC on the possible need for central bank actions, including the potential need for formal approvals.
- 24) The OC will, without undue delay, review the proposal to identify any issues or concerns it may have, and seek to resolve such issues or concerns with the relevant parties as necessary and appropriate. Depending on the issues identified, it may be CLS or others that need to address the OC's concerns.
  - A) The OC will review CLS' continued observance of the PFMI with regard to such proposals.
  - B) Each participating central bank will review such proposals against any other applicable laws, regulations and policies for which the central bank is responsible.
  - C) The OC can identify the potential need for additional time and/or information for the review of such proposals, while seeking to avoid undue delays in the review/approval process.
- 25) Formal responses by the Federal Reserve Board (e.g., indicating no objection; objections; or approval), if necessary, as well as any requests for additional time and/or information on the proposed changes will be communicated to CLS by the Federal Reserve within 60 days of receiving the proposal notice.
  - A) For complex or significant proposals, where participating central banks require additional time for their respective assessment, the Federal Reserve will coordinate and communicate appropriate timelines with the OC and CLS.
  - B) For proposals that the Federal Reserve Board identifies as requiring its approval or other formal action, each RSO, at a minimum, will be asked to provide formal notice to the Chairperson of the OC as to whether its central bank objects or does not object to the proposal. The RSO will be deemed to have raised no objection if they do not respond to the Chairperson within the specified OC review period.

- C) For proposals that the Federal Reserve Board does not identify as requiring its approval or other formal action, RSOs will not be asked to provide formal notice to the Chairperson of the OC as to whether its central bank objects or does not object to the proposal.
- 26) In cases where CLS makes formal commitments to the participating central banks associated with a given proposal, the OC will review and assess CLS' fulfillment of the commitments.

### ***Oversight Information***

- 27) The OC will, as needed, discuss and seek consensus on the evolving ad hoc, periodic and routine information it may require to carry out its oversight responsibilities.
- A) In this regard, the participating central banks will seek to avoid duplicating efforts or unduly burdening CLS.
  - B) Possible sources for the necessary information include CLS, the RTGS operators group, participating central banks, and/or Federal Reserve supervisors through, for example, written reports and/or meetings with the OC. The Federal Reserve, as primary overseer of CLS, will make best efforts to ensure such information is provided to the OC.

### ***Exchange of Information between Participating Central Banks and Federal Reserve Supervisors of CLS***

- 28) The OC interacts with Federal Reserve supervisors to ensure that the oversight and supervisory processes can inform and support each other through effective coordination and communication.
- A) Discussions and other communications between the OC and Federal Reserve supervisors are designed to enhance the effectiveness and to leverage the strengths of overseers and supervisors in furthering their common interests regarding the safety and efficiency of CLS and the stability of the financial system.
  - B) For instance, the annual RSO meeting will provide an opportunity for overseers to share insights and to identify questions and concerns that could inform supervisors in the design and scheduling of their upcoming activities vis-à-vis CLS.
  - C) Similarly, the annual RSO meeting will provide an opportunity for supervisors to share insights and to identify questions and concerns that could inform overseers in the design and scheduling of their upcoming activities vis-à-vis CLS.
- 29) The Federal Reserve has a framework for sharing confidential supervisory information, including an annual supervisory assessment and individual examination reports, with the participating central banks.

- A) Federal Reserve supervisors also provide regular updates on important supervisory themes, examinations, plans, and current issues at OC meetings. The OC discusses with, and provides perspectives to Federal Reserve supervisors regarding these and other relevant matters.

### ***Procedures to Achieve Consensus***

- 30) As a matter of intent, the participating central banks aim to reach compatible assessments of CLS with respect to the PFMI and to take compatible actions with regard to their oversight of CLS through a cooperative process of consultation, with the intention of achieving common understanding and consensus in the OC.
- 31) However, issues and differences that cannot be resolved by the RSOs can be referred by the RSOs to their respective Governors for further guidance, including potential action under their respective authorities.
  - A) Governors may discuss such matters among themselves, instruct the RSOs to discuss the matter further, or pursue action under their respective individual authorities, as they see fit.
- 32) Procedures for escalating and resolving disputes within the OC and for escalating issues to the Governors are documented in the CLS Oversight Guide.

### **Confidentiality**

- 33) As noted above, members of the OC will receive non-public information regarding CLS ("Confidential Information") from several sources in connection with their oversight activities under this Protocol, including Confidential Information from CLS, Federal Reserve supervisors, and the individual participating central banks. Federal Reserve supervisors will provide Confidential Information to the OC and the participating central banks in accordance with Federal Reserve procedure.
  - A) ***General requirements for use and confidentiality of Confidential Information.*** All such Confidential Information will be treated as confidential by the receiving party to the extent permitted by applicable law and, subject to Federal Reserve procedure and the provisions on disclosure below, will be used by, within, and among the participating central banks only for oversight purposes or in connection with their responsibilities regarding the application of applicable laws, regulations, and policies. Confidential Information received by a participating central bank from any other participating central bank, including Federal Reserve supervisors, will not be shared with others except as provided below.
  - B) ***Onward disclosure of Confidential Information received from another participating central bank, including Federal Reserve supervisors.***
    - Except as provided in the next paragraph or in subsection C below, before a central bank discloses any Confidential Information received from another participating central bank, the central bank wishing to make the disclosure will request and obtain prior consent from the originating central bank which shall not be unreasonably withheld. Each central bank will endeavor to respond to a request to disclose information within twenty (20) days.

- In the event that a participating central bank is required by statute or legal process to disclose Confidential Information provided by another participating central bank, the central bank receiving Confidential Information will, to the extent permitted by law, inform the central bank that provided the Confidential Information about such possible compelled disclosure and seek the providing central bank's prior consent. If the central bank that provided the information does not consent to such disclosure, the participating central bank that is compelled to disclose the Confidential Information will, to the extent possible and appropriate, take reasonable steps to resist disclosure, including by employing legal means to challenge an order that compels disclosure.
- No privileges, immunities, or confidentiality associated with Confidential Information provided by a participating central bank are intended to be waived as a result of sharing such information pursuant to this Protocol.

C) ***Prior consent granted for certain onward disclosure.*** Notwithstanding the requirements of subsection B,

- The European Central Bank may disclose Confidential Information provided by another participating central bank, other than examination reports or other supervisory communications which the European Central Bank received from the Federal Reserve following a specific request approved pursuant to Federal Reserve procedure, to the national central banks of the Eurosystem, subject to the European Central Bank obtaining the receiving central bank's agreement to keep such information confidential and not further disclose the information except in accordance with this section, and
- A participating central bank may disclose Confidential Information provided by another participating central bank, other than Confidential Information provided by Federal Reserve supervisors, to their national bank regulatory authorities or finance ministries, subject to the participating central bank obtaining the recipient's agreement to keep such information confidential and not further disclose the information except in accordance with this section.

34) ***Disclosure of assessments.*** Nothing contained herein is intended to limit the ability of any participating central bank to treat its respective Confidential Information in accordance with its applicable laws and practices, provided, however, that assessments (including results and related reports) of CLS against the PFMI will not be disclosed to the public unless the participating central banks agree otherwise. Notwithstanding the foregoing, a participating central bank may inform financial institutions of, or otherwise make public, risks or deficiencies it has identified at CLS, even when the knowledge of such risks or deficiencies is partly or in whole based on Confidential Information, so long as no Confidential Information provided by any other party to this Protocol is disclosed or attributed to such party, except in accordance with the preceding section.

#### **Amendments to the Protocol**

35) This Protocol may be modified, as necessary, subject to the consensus by the Governors of the participating central banks.