



Memorandum

Date: February 28, 2007

To: CLS RM Primary Contacts for Members
CLS Third Party Working Group

From: Joe Halberstadt, Senior Product Manager
Mandy Lam, Associate General Counsel

Subject: Revised Draft CLS Bank FX Protocol

REQUESTED ACTION: Comments by March 16, 2007

We are pleased to report that the CLS Bank FX Protocol has been revised to reflect comments from and discussions with several CLS Bank Members and regional FX industry groups. We strongly encourage your institution to distribute these materials to all relevant departments (including legal and operations) within your institution. ***Any additional comments should be sent by email to Mandy Lam (mlam@cls-bank.com), with a copy to Joe Halberstadt (jhalberstadt@cls-services.com), no later than Friday March 16.*** This will allow CLS Bank to publish the final FX Protocol materials shortly thereafter and launch the FX Protocol in April for all FX market participants. It is important to understand that once the FX Protocol is launched, it cannot be modified.

I. Revised Documentation

Attached are copies of the following three documents relating to the FX Protocol:¹

- Revised draft CLS Bank FX Protocol (clean and marked copies)
- Revised draft Frequently Asked Questions (FAQs) (marked copy)
- Revised draft Procedures (marked copy)

II. Most Significant Changes

The most significant changes to the FX Protocol are:

1. Adherence Letter May Cover Multiple Entities.
 - (a) An institution may, but is not required to, submit a single Adherence Letter adhering it and one or more of its affiliates to the FX Protocol. An institution wishing to take advantage of this is required to submit an Adherence Letter that specifically identifies each relevant affiliate and represent to each other Adhering Party that it has the requisite authority to bind the affiliate. This option is useful to an institution that finds it administratively convenient to submit one Adherence Letter covering it and, e.g., all its dealer affiliates, *provided* that it has the requisite authority to bind such affiliates.

¹ Marked copies reflect changes from the November drafts previously circulated to your institution.

- (b) CLS Bank Members continue to be bound to the FX Protocol through the CLS Bank Member Handbook and therefore are not required to submit any Adherence Letters for the FX Protocol. However, if a Member wishes to bind any of its affiliates, it may now do so by submitting an Adherence Letter covering one or more of its affiliates as described above.²
 - (c) An investment or asset manager may now submit a single Adherence Letter on behalf of one or more of its funds. ***For those institutions that are involved in the fund FX market, we would greatly appreciate feedback as to whether the proposed forms of letters (Exhibits 1C, 2B and 3B to the FX Protocol) are appropriate, specifically the identification of individual funds in the letters to (i) by fund name or by reference to the funds covered by the relevant Master Agreement in place with another Adhering Party (see Exhibit 1C); and (ii) by fund name or fund identifier or by reference to the funds covered by the relevant Master Agreement in place with another Adhering Party (see Exhibits 2B and 3B).***
 - (d) Similar to the way in which an institution may cover one or more of its affiliates or funds in a single Adherence Letter, the institution may also cover one or more of its affiliates or funds in a single Adoption of Best Practice Letter (and, if applicable, Adoption of Best Practice Supplemental Letter).
2. Acknowledgement of Scope of the FX Protocol. In new Section 3 of the FX Protocol, each Adhering Party is required to acknowledge the scope of the FX Protocol, specifically:
- (a) The FX Protocol does not apply to any FX Transaction where related FX Instructions are not submitted to the CLS System; and
 - (b) Another Adhering Party's adherence to the FX Protocol alone does not provide any indication of its adoption of the Best Practice;
 - (c) Because any adoption of the Best Practice by the Adhering Party (i) only addresses whether the Adhering Party requires the **receipt** of separate

² Although it was suggested that CLS Bank consider automatically binding dealer affiliates of Members to the FX Protocol, after careful consideration CLS Bank has concluded that it would not be appropriate or prudent to do so because (i) not all Members are currently authorized to bind their dealer affiliates; and (ii) even if a Member is not currently authorized to bind its dealer affiliates, it is unclear whether such Member would be willing to obtain such authorization or, even if it was willing to do so, there may be other legal or regulatory impediments in its ability to obtain such authorization. In our view, the revised draft is not only efficient and flexible (a Member may submit a single Adherence Letter that covers one or more of its affiliates, but is not required to do so), but also would not cause Members who do not have, or are unable to obtain, the requisite authorization to bind its dealer affiliates to breach the representation that it does in fact have such authorization.

We further note that a general reference to "affiliates" or "dealer affiliates" being bound to the FX Protocol could be confusing to the other Adhering Parties. It is extremely important that there be clarity surrounding which specific legal entities are in fact Adhering Parties. This is especially true in the context of the Best Practice.

confirmations of FX Transactions if the related FX Instructions have been matched in the CLS System, and (ii) does not address whether such Adhering Party may be required to **send** such separate confirmations to another Adhering Party (unless such other Adhering Party has indicated its adoption of the Best Practice through this FX Protocol or otherwise), whether the Adhering Party is required to send, or continue to send, separate confirmations to another Adhering Party that has **not** agreed to be bound by the Best Practice through this FX Protocol or otherwise will depend on the arrangements and agreements which are specific to the two Adhering Parties (whether currently in place or as amended by the two Adhering Parties) and separate from this FX Protocol.

Although the above was and continues to be described in the FAQs, several institutions commented that it would be useful to include specific language in the FX Protocol itself.

III. Update on CLS Bank NDF Protocol

As indicated in the cover memorandum that accompanied the November draft FX Protocol materials, once the FX Protocol has been launched, CLS Bank will begin preparing materials for a CLS Bank NDF Protocol. The structure of the NDF Protocol and the procedures relating thereto will be substantially similar to, but entirely separate from, the FX Protocol. It is our expectation that the NDF Protocol will be launched simultaneously with the commencement of CLS Bank's NDF service.

On December 13, 2006, the Foreign Exchange Committee (FXC), Foreign Exchange Joint Standing Committee (FX JSC) and EMTA, Inc. (EMTA) jointly published a final form of *Master Confirmation Agreement for Non-Deliverable Forward FX Transactions*³ which is a bilateral version for use by NDF market participants. CLS Bank is in the process of identifying which subset of interested financial institutions from those groups is working on developing the multilateral version of the NDF Master Confirmation for NDF Transactions whose payment instructions are processed and matched in the CLS System for CLS Bank Settlement.⁴ It is anticipated that the NDF Master Confirmation specially tailored for CLS, which we plan to incorporate by reference into the NDF Protocol, will be published by the relevant industry group(s) on a publicly available website. We will advise your institution when these materials become available.

³ This form of NDF Master Confirmation, as well as a User's Guide that includes general practice notes regarding its use, are publicly available on the FXC website: <http://www.newyorkfed.org/FXC/news/index.html>.

⁴ As previously indicated, the FXC OMWG (Operating Managers Working Group) and FMLG (Foreign Markets Lawyers Group) have advised CLS Bank that they favor an NDF Master Confirmation specially tailored for CLS that contains the following provisions: (i) similar to the bilateral form, incorporates by reference the NDF currency templates published by EMTA, including any updates to such templates; (ii) the two Adhering Parties to the NDF Protocol would be joint calculation agents when each is a CLS Bank Member (or a dealer affiliate of a Member) or when neither is a CLS Bank Member (or a dealer affiliate of a Member); (iii) if two Adhering Parties have signed a bilateral NDF master confirmation before they both have adhered to the CLS NDF Protocol, the CLS NDF Protocol would supersede the bilateral NDF master confirmation to the extent it is inconsistent with it; and (iv) if two Adhering Parties sign a bilateral NDF master confirmation after they both have adhered to the CLS NDF Protocol, the bilateral master confirmation would supersede the CLS NDF Protocol to the extent inconsistent.