



FINANCIAL SERVICES COMMISSION

MINIMUM REQUIREMENTS FOR CLIENT – DEALER REPURCHASE AGREEMENTS

1.0 BACKGROUND

The Securities Dealers operating in Jamaica have for some time been financing large volumes of securities investments by entering into short term repurchase agreements (“repos”) with their clients. The Financial Services Commission (“FSC”) is implementing rules for the industry to limit this practice. The FSC has enunciated these rules in the guidance paper SR-GUID-04/07-0010, entitled “MARGIN REQUIREMENTS FOR REPURCHASE AGREEMENTS” (“Margin Requirements”), which requires inter alia that:

“The minimum margin for repos on all securities shall be 50% for repos entered into after December 31, 2004, except in the case of repos entered into under repurchase agreements approved by the FSC.”

In other words, under the FSC’s Margin Requirements, for a repo to be eligible for margins less than 50% the actual terms, conditions and other features of the repo must meet the FSC’s approval. A set of approval criteria has been developed in order to assist securities dealers in meeting this requirement.

2.0 REQUIREMENTS FOR CLIENT REPURCHASE AGREEMENTS

In order to be considered for approval by the FSC, the repo agreement must not contain any other substantive provisions that contradict terms 2.1 to 2.23 outlined below. Schedule I of this guideline lists examples of contract term provisions, the normal content of which would not ordinarily be considered by the FSC to be contradictory. It should be noted also that the FSC will take into consideration all relevant factors and therefore compliance with these requirements will not by itself guarantee approval by the FSC.

In developing the requirements, master repurchase agreements presently being used both locally and internationally were reviewed. Clauses which are considered essential for a repo agreement were identified, and are outlined below:

2.1 Description of the security used as collateral – This should include

- The type of instrument (bond, treasury bill, etc)
- The term remaining to maturity or maturity date
- Name of issue
- Coupon
- Face Value of the security

2.2 Type of deal – The document should state specifically that the investment will be a repurchase agreement, and a definition of a repurchase agreement should be included.

A possible definition –

A “Repurchase Agreement” is a contract between an institution and an investor to sell securities for cash while simultaneously agreeing to repurchase these securities some time in the future for a specific price.

2.3 Plain English – The document should be written in language that can be understood by the average investor.

2.4 Purchase Price and Repurchase Price – The purchase price, as well as the repurchase price, agreed between the buyer and seller should be stated in the document.

2.5 Interest Rate – The document must indicate the interest rate applicable to the transaction.

2.6. Currency of payment – The currency in which payments will be made should be stipulated.

2.7 Start and End date of the transaction - The transaction date, purchase date and repurchase date should be specified.

2.8 Day Count – the method used to calculate the yield on the transaction should be stated. (e.g., actual/360, actual/365, etc.)

2.9 Risks associated with the instrument -

The document should:

- state that in the event that the dealer fails to repurchase the security then all the risk associated with owning the underlying security will be borne by the client.
- state that repurchase agreements are not bank deposits.
- indicate that if the client wants an early termination of the repurchase agreement, then (if and to the extent that the dealer is willing to facilitate such a request) the dealer may impose a penalty (the basis used to determine the penalty should be specified in the agreement).

2.10 Initiation and Confirmation

The document should state:

- that an agreement to enter into a repurchase transaction may be initiated by either the buyer or the seller.

- whether or not such agreement must be in writing or may be made orally.
- that on the purchase date, the seller will deliver the securities purchased to the buyer or its agent along with the relevant documentation detailing the full description of the security being purchased and the buyer shall pay the agreed purchase price to the seller.
- delivery may be into the custody of the seller (as custodian and agent for and on behalf of the buyer) in accordance with term 2.12 hereof.

2.11 Ownership of Securities

The document should indicate that the beneficial ownership of the purchased security shall pass from the seller to the buyer on the purchase date. It should also state whether or not the buyer is prevented from engaging in other repurchase agreements using the purchased securities or otherwise selling, transferring, pledging or hypothecating the purchased securities; however, if such transactions are permitted no such transaction will relieve the buyer from its obligation to transfer the purchased security on the repurchase date.

2.12 Custody of Securities

The document should state whether or not the assets comprising the buyer's investment are to be held by the seller as custodian and agent for and on behalf of the buyer. Where the seller is to act as custodian for the buyer these assets shall not form part of the assets of the seller but shall be held in a custodial capacity only.

2.13 Segregation of Securities Sold under Repurchase Agreements

The document should state that all securities sold under repurchase agreements that remain in the possession of the seller shall be separated from other securities in its possession and shall be identified as subject to a repurchase agreement.

2.14 Issuance of Certificate

Where the seller retains custody of the securities as agent for and on behalf of the buyer, the seller of the securities shall issue a certificate to the buyer as evidence of the beneficial ownership of the purchased security and confirming that the securities are held by the seller. On the repurchase date, the seller may require the buyer to return the certificate in exchange for the repurchase price.

2.15 Substitution

The document should state whether or not the seller may substitute other securities for the purchased securities. Where the document permits substitution, the document should state that –

- (a) after substitution, the substituted securities will become the purchased securities, and
- (b) as a condition of substitution the new securities, at the time of the substitution, must have a market value equal to or greater than the market value of the original securities for which they were substituted.

2.16 The events that would constitute a default-

The document should state the events that would constitute a default including, but not limited to, the following:

- a. If the seller fails to transfer the purchased security to the buyer upon becoming obliged to do so
- b. If the buyer fails to pay the purchase price to the seller in respect of the transaction upon becoming obliged to do so
- c. If the seller fails to repurchase, or the buyer fails to transfer the purchased security on the repurchase date
- d. If the seller or buyer admits to its inability to, or its intention not to, perform any obligation stipulated in the contract
- e. If the seller or buyer fails to deliver the purchased security along with the relevant documentation duly endorsed or executed
- f. If the seller or buyer commits a breach of any part of the agreement
- g. If an act of insolvency (which should be defined in the agreement) occurs with respect to either the seller or the buyer
- h. If any representations made by the seller or buyer are incorrect or untrue in any material respect.

The document should also identify the rights and remedies arising as a consequence of the occurrence of such default.

2.17 Non – Assignability

The document should state that the rights and obligations of either party under the agreement cannot be assigned without the prior written consent of the other party.

2.18 Governing Law

The document should state that the agreement is governed by and construed in accordance with Jamaican Law unless the buyer or seller is resident in another jurisdiction and the parties elect to have the document governed by the law of that jurisdiction or by a neutral body of law.

2.19 Disclosure

The seller should warrant to the buyer that the seller has disclosed to the buyer all information which would be considered material to the purchaser of the underlying security.

Such a warranty need not be given where the securities are instruments issued by the Bank of Jamaica, the Government of Jamaica, the Governments and Central Banks of G-10 and CARICOM countries or entities owned and controlled by such Governments.

2.20 Authorized Signatories

Where the buyer in the transaction is a company then each party shall on signing the agreement deliver to the other a mandate, signed by the managing director or by the chief executive officer and its company secretary, confirming the names of the persons who have been authorized by its board of directors to sign transaction confirmations, endorsements of securities and ancillary documents on its behalf.

Specimen signatures of such persons should be attached to the mandate. No change in such signing authority should be effective unless and until a revised mandate, signed by the managing director or chief executive officer and its company secretary, has been delivered to the other party.

2.21 Arbitration

The document may provide for the parties to submit disputes, arising out of or concerning the agreement or any transaction thereunder, to arbitration under the Arbitration Act or to settle such disputes by some other alternative dispute resolution (“ADR”) mechanism.

This clause should not however apply in the event that an act of insolvency has occurred in relation to either party prior to the commencement of the arbitration or other ADR mechanism, and should not prohibit a party seeking interlocutory remedies from the Court arising out of the other party’s breach of the agreement.

2.22 Amendments to the Agreement

The agreement may only be varied, modified or amended by instrument in writing executed by both parties.

2.23 Master Agreements

Repurchase agreements may for convenience be written in the form of Master Agreements, wherein the standard terms and conditions are set out in an agreement, which is signed once by the client. In such cases each specific transaction is to be evidenced by a transactional confirmation which would include the terms and conditions specific to the transaction (date, interest rate, amount, etc) as well as a provision incorporating by reference all of the provisions of the Master Agreement. The terms and conditions in the transactional confirmation cannot vary, alter or modify in any way the terms and conditions of the Master Agreement and a clause to this effect must be included in the Master Agreement.

The Master Agreement document should state:

- that from time to time two parties (the institution and the client) will enter into a transaction where the seller agrees to sell to the buyer securities for specific periods of time. At the end of this period, the buyer agrees to sell and the seller agrees to repurchase the securities at a specified price.
- that unless otherwise specified, the contract should apply to all repurchase transactions between the institution and the client.

Schedule I which is attached forms part of this document.

SCHEDULE I

Pursuant to paragraph 2.0 of FSC guideline “Minimum Requirements for Client – Dealer Repurchase Agreements” (SR-GUID-04/07-0012) the following are examples of additional matters with respect to which provisions may be incorporated in the repurchase agreement. Securities Dealers should ensure that such additional provisions incorporated in their repurchase agreements do not contradict the items at paragraphs 2.1 to 2.23 of the guidelines.

- a) Joint Accounts
- b) Right of set off
- c) Method of payment and settlement
- d) Withholding Tax
- e) Confidentiality
- f) Overpayments
- g) Representations and warranties
- h) Capacity to contract
- i) Indemnification for dishonoured payments
- j) Right to record conversations as evidence
- k) Acting on faxed or e-mail instructions (and related indemnities)
- l) Credit facilities secured by the client’s rights and interest under repurchase agreements

Please note that this is not intended to be an exhaustive listing of all possible provisions which can be incorporated in the agreement.