



FINANCIAL SERVICES COMMISSION

GUIDELINES FOR MARGIN REQUIREMENTS FOR REPURCHASE AGREEMENTS

1.0 INTRODUCTION

- 1.1 These guidelines are being issued for the purpose of regulating the use of credit by dealers. Breach of these guidelines will constitute evidence of failure to meet prudent practices and indicate that the entity is engaged in unsafe and unsound practices.
- 1.2 The Securities Act provides for the making of regulations governing margin requirements. These guidelines for margin requirements for repurchase agreements are currently being drafted into regulations. Once the substance of the guidelines is promulgated in the form of regulations, a breach of its provisions shall be an offence. The Financial Services Commission ("FSC") has imposed margin requirements for the purpose of preventing the excessive use of credit for the purchase or carrying of securities by dealers.
- 1.3 The FSC has also separately issued guidelines surrounding the treatment of securities acquired on margin which is directed at margin borrowing by securities dealers from broker-dealers, which are generally overseas broker-dealers, to finance the acquisition of foreign currency instruments. These guidelines (which are contained in the FSC release entitled "Treatment of Securities Acquired on Margin", numbered SR-GUID-04/07-0009) will be included in the proposed regulations.

2.0 BACKGROUND

- 2.1 Over the years, a practice has developed whereby licensed securities dealers finance large volumes of investments in securities by short term repurchase agreements entered into with their investing clients instead of selling such securities outright to their investing clients or selling such securities into registered pooled investment vehicles for the benefit of their investing clients. This practice, therefore, involves the dealers entering into a borrowing relationship with their clients and exposes the enterprise to significant risks, primarily liquidity and interest rate risks.

- 2.2 The Securities Act (as amended) (the “Act”) anticipated that it might be necessary for regulations to be imposed to prevent the excessive use of credit by securities dealers. Section 42 of the Act provides as follows:

“For the purpose of preventing the excessive use of credit for the purchase or carrying of securities by dealers or member dealers, regulations may provide for margin requirements, that is to say, the amount of credit that may from time to time be extended and maintained on all or specified securities or transactions or class of securities and transactions and for matters connected therewith.”

3.0 MARGIN REQUIREMENTS

The FSC has adopted the following rules in order to correct the current situation and prevent the excessive use of credit for the purchase or carrying of securities by securities dealers.

3.1 Definitions

“Allowable Assets” means-

- (a) “Securities” as defined in the Securities Act, but are not:
 - i) stocks or shares issued or proposed to be issued by a company or unincorporated body;
 - ii) rights or options in respect of securities;
 - iii) certificates of interest or participation in any profit sharing agreement; or
 - iv) collateral trust certificates, preorganization certificates, or subscriptions, transferable shares, investment contracts, voting trust certificates or certificates of deposit for securities; and
- (b) Instruments issued by the Bank of Jamaica.

“Client” means a party, not being a licensed dealer or regulated deposit taking institution, which purchases securities from a dealer under a repurchase agreement.

“Dealer” means a licensed securities dealer.

“Fair Value” means the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arms length transaction. Any

reference to “fair value” in this guideline is a reference to the clean price of an asset (i.e. the agreed settlement amount less accrued interest)

“**Margin**” means the difference between the fair value of the security to be repurchased and the initial purchase price in dollars of the repurchase agreement. This margin will be expressed as a percentage of the initial purchase price of the security to be repurchased.

“**Repurchase agreement**” or “**Repo**” means an agreement between a seller and a buyer whereby the seller agrees to repurchase and the buyer agrees to resell the securities sold, at an agreed upon price and at a stated date and shall include certificates of participation (“COP”) where EITHER the contractual interest payment or principal repayment date or dates of the COP is or are not identical to the contractual interest payment and principal repayment date or dates, respectively, of the security being participated, OR any investor in the COP has been paid interest or repaid all or part of his or her principal investment on a date that is not a contractual interest payment or principal repayment date, respectively, of the security being participated.

3.2 **No unsecured borrowing from investors**

Dealers may not borrow funds on an unsecured basis except:

- (a) from a licensed deposit taking institutions, local or foreign;
- (b) from other dealers, local or foreign;
- (c) the borrowing is in the form of deposits and the dealer is a licensed deposit taking institution; or
- (d) borrowing by dealer that is a registered insurer
- (e) where such borrowing qualifies as capital, and is in compliance with the guidelines for issuers of securities SR-GUID-02/12-0005 and other applicable laws.

3.3 **Only allowable assets may be used as collateral**

Dealers may not enter into repurchase agreements except where the asset that is the subject of the repurchase agreement is an allowable asset.

3.4 **Aggregate repurchase agreement obligations to be restricted**

From the effective date of these rules (December 31, 2004), a dealer’s aggregate balances of repurchase agreements with clients shall not at any time exceed the higher of its aggregate repo balances as at July 31, 2004 and 50 percent of the dealer’s total assets and funds under management.

3.5 **Minimum margin requirement on repurchase agreements**

- i) Dealers shall not enter into repurchase agreements with clients unless the fair value of the security or securities being sold exceeds the initial purchase price in

dollars of that repurchase agreement by a minimum margin. This requirement is not applicable to arrangements referred to as Bank of Jamaica repurchase agreements evidenced by Certificates of Securities Held which are sold or assigned to clients of the dealer.

- ii) The minimum margin shall be 50% for repos on all securities entered into after December 31, 2004 except in the case where the repurchase agreements have been approved by the FSC¹.
- iii) For repos that fall under repurchase agreements approved by the FSC, the minimum margin shall be in accordance with the following provisions:
 - a) The minimum margin for repos on securities issued by the qualifying following issuers listed on Schedule I shall be 1% for repos entered into after December 31, 2004 and shall increase in accordance with the following schedule:

Minimum Margin	Applicable to Repos entered into after:
1%	December 31, 2004
3%	September 30, 2005
5%	March 31, 2006

- b) The minimum margin for repos on all other allowable assets shall be 3% for repos entered into after December 31, 2004 and shall increase in accordance with the following schedule:

Minimum Margin	Applicable to Repos entered into after:
3%	December 31, 2004
9%	September 30, 2005
15%	March 31, 2006

- iv) The minimum margins will be reviewed periodically by the FSC and are subject to change.

¹ The approval criteria to be used by the FSC are contained in the Guideline paper entitled "Minimum Requirements for Client - Dealer Repurchase Agreements" (SR-GUID-04/07-0012).

3.6 Reporting

Dealers with outstanding repurchase agreements are required to report to the FSC in accordance with regulations 13 and 14 of the Securities (Conduct of Business) Regulations. In addition, dealers should file with the Commission, for each month in which it has had outstanding repurchase agreements, a completed C1 Form, a Profit and Loss Statement and a Balance Sheet. The monthly C1 Form, Profit and Loss Statement, and Balance Sheet are to be delivered to the FSC by the 15th day of the month following.

3.7 Transitional

- a) These requirements are to be effective for all transactions entered into by securities dealers after December 31, 2004.
- b) Dealers that anticipate difficulty in meeting the requirements by the due date specified in paragraph 3.4 of this paper must apply to the FSC for permission to meet the requirements on an extended plan in accordance with the provisions set out in paragraph 4.3 of the FSC Guidelines for Interim Capital Standards for Securities Dealers (SR- GUID- 04/07-0011)
- c) Dealers must submit an agreement for approval to the FSC by September 30, 2004. Each agreement submitted will be assessed by the FSC using the approval criteria contained in the Guideline paper entitled "Minimum Requirements for Client - Dealer Repurchase Agreements" (SR-GUID-04/07-0012). Once a decision has been taken by the FSC whether to approve or reject an agreement submitted, formal notification of that decision will be sent to the dealer by the FSC.
- d) Dealers that submit to the FSC by September 30, 2004 repurchase agreements accompanied by a certificate of compliance signed by independent legal counsel may proceed as if their agreement had been formally approved by the FSC until they are otherwise notified by the Commission. The certificate of compliance submitted must indicate clearly that the legal counsel has reviewed the dealer's repurchase agreement and found that it is in compliance with the general terms and conditions contained in section 2.0 of the Guideline paper entitled "Minimum Requirements for Client - Dealer Repurchase Agreements" (SR-GUID-04/07-0012).

SCHEDULE I

List of Qualifying Issuers

1. Government of Jamaica (“GOJ”), including central government, statutory bodies, companies owned or controlled by the GOJ and agencies of the GOJ.
2. Bank of Jamaica
3. Governments and Government Agencies of Caricom Countries if approved by the Commission
4. Governments and Government Agencies of the United States, Canada, and the United Kingdom
5. Governments and Government Agencies of the G-10 countries (excluding the United States, Canada, and the United Kingdom) if approved by the Commission