

SR-ADVI-14/10-0008



SECURITIES INDUSTRY ADVISORY

THE NEW RETAIL REPO OPERATIONAL FRAMEWORK

The Financial Services Commission  
39-43 Barbados Avenue  
Kingston 5, Jamaica W.I.  
Telephone No. (876) 906-3010

October 17, 2014



FINANCIAL SERVICES COMMISSION  
ADVISORY PAPER FOR NEW RETAIL REPO OPERATIONAL FRAMEWORK  
OCTOBER 15, 2014

---

## 1.0 BACKGROUND

- 1.01 Over the years, an industry practice has developed whereby securities dealers finance large volumes of investments in securities by short term repurchase agreements entered into with investors. The securities dealers retain the securities underlying the repurchase agreements in their custody and give beneficial interests in the securities instead of selling or transferring legal title of such securities outright to investors. This practice, known as the "retail repo" business in its current format, poses a number of risks to securities dealers and investors. A critical component of the Government of Jamaica's financial sector reform programme is to implement a strategy to reduce the risks associated with the retail repo business of securities dealers.
- 1.02 The Financial Services Commission (FSC) has been charged with the responsibility of facilitating the establishment of a trust to mitigate the investors' risk of loss from dealer default, bankruptcy and other legal risks associated with the retail repo product. A new retail repo transaction structure is being set-up, which will involve the JCSD Trustee Services Limited (trustee) functioning as trustee and registrar to hold the securities underlying retail repos in trust for the benefit of retail repo investors. This will ensure that these underlying securities are held apart from the dealer's estate in the event of its default. It will also facilitate the trustee taking appropriate actions in the event of a transaction failure or default to ensure that the beneficial interests of retail repo investors are adequately protected.
- 1.03 The Operations Working Group<sup>1</sup> (OWG) explored various options for improving the retail repo transaction structure with the broad objective of significantly enhancing the level of protection offered to retail repo investors. Further to the circulation of the Discussion Paper on the Proposal for the New Retail Repo Transaction Structure and Related Operational Process Flows (SR-CONSUL-14/04-0027), and the responses from industry participants, the transaction structure has been simplified.

---

<sup>1</sup>A steering committee was set up to guide the retail repo transition project. In addition, three working groups (The Legal and Regulatory working group, Operations working group, and Transitions working group), led by two project managers, were established to carry out the necessary work streams.

- 1.04 The flow of the retail repo transactions data will now pass directly to the Jamaica Central Securities Depository (JCSD) instead of through JamClear-CSD and there will be net settlement of funds and securities. The net settlement of funds will occur in JamClear-RTGS while the net settlement of securities will occur in (i) JamClear-CSD for securities registered on JamClear-CSD; (ii) approved international custodian banks for global bonds; and (iii) JCSD for approved locally issued corporate bonds.
- 1.05 The potential benefits of the amendments to the proposal include:
- (i) significant reduction in the amount of modifications required by the JamClear systems;
  - (ii) reduction in system modifications/development required by dealers and the JCSD;
  - (iii) reduced need for liquidity to settle funds on a net basis instead of gross (transaction by transaction);
  - (iv) reduced need for capital to purchase additional securities to clear transactions net instead of gross; and
  - (v) possible reduction in the transaction costs for users.

## 2.0 FEATURES OF THE NEW RETAIL REPO OPERATIONAL FRAMEWORK

The critical components which will guide the new operational framework for retail repos are outlined below:

### 2.01 Definition of Retail Repo

The definition of retail repo<sup>2</sup> is as follows:

*"a repurchase agreement, whereby a person, other than a prescribed investor<sup>3</sup>, agrees to pay a specific sum to a securities dealer in return for a beneficial interest in a security and in which there is a transfer of legal title in the security from the securities dealer directly to a third party trustee, on behalf of that person; coupled with a corresponding agreement by the dealer to repurchase the interest in the securities from that person at an agreed future date for an agreed future sum."*

### 2.02 Elements of Retail Repo Transactions

The transaction structure addresses the main elements of the retail repo transactions and includes:

- a. The creation of a new retail repo contract;
- b. the rollover of an existing retail repo contract;
- c. the termination of a retail repo contract (full encashment);
- d. the partial encashment of a retail repo contract; and

---

<sup>2</sup> The current definition of retail repo refers to repurchase agreements with individuals and non-financial institutions. However, in the new operational framework, the classification will be dependent on the treatment of the underlying securities. Of note, repurchase agreements currently done via the pledge operation type on JamClear-CSD will not be allowed. These transactions will be treated as a separate collateralized borrowing obligation and will require separate legal documentation and the utilization of a centralized pledged management facility in JamClear-CSD.

<sup>3</sup> A prescribed investor may be defined as licensees of the Bank of Jamaica (BOJ), licensees of the FSC and corporate entities/individuals with individual client accounts in JamClear-CSD or approved international custodians.

e. the substitution of securities underlying a retail repo contract.

2.03 Minimum Transaction Size

All retail repos registered in the trust framework must meet the standard minimum transaction size as specified by the FSC. Of note, the minimum transaction size will serve as a floor, therefore, an individual dealer in keeping with its own business model can determine a higher amount.

2.04 Funding Currencies

There will be two funding currencies available for retail repos under the trust arrangement, namely Jamaican dollar (JMD) and United States Dollar (USD).

2.05 Cross Currency Transactions

Cross currency transactions will be facilitated using two currencies, namely JMD and USD. The BOJ ten-day moving average rate will be used for the conversion of these transactions. An additional minimum margin requirement will be specified by the FSC for these transactions.

2.06 Universe of Allowable Securities

A pool of allowable securities that can be used as collateral for retail repo transactions will be established and will include dematerialized and/or immobilized securities as specified by the FSC.

a) Dematerialized Securities will include:

- GOJ issued and GOJ guaranteed securities
- Securities issued and or guaranteed by US, Canada and UK sovereigns.
- Foreign currency denominated investment grade sovereigns and corporates in keeping with the FX cap outlined by section 22 of the BOJ Act.

b) Immobilized Securities will include:

- GOJ issued and GOJ guaranteed securities
- Locally issued secured corporate bonds
- Foreign currency denominated investment grade corporates in keeping with the FX cap outlined by the BOJ.

2.07 Margin Requirements

All retail repo transactions will require an initial margin as well as a daily maintenance margin at the percentages stipulated by the FSC.

2.08 Valuation Methodology for Allowable Securities

A standardized valuation methodology, namely the Bloomberg yield curve, will be used to determine the market value for all securities underlying retail repo contracts that are held by the trustee. The mark to market valuation of all securities held will be conducted at the start of each day by the trustee using closing prices from the previous day.

## 2.09 Operating Rules & Schedule

The new operational framework will be guided by rules for participation in the trust arrangement and for the registration and settlement of retail repo transactions. These rules will be supported by a schedule which will identify initial and final cut-off times for transaction file upload to the trustee, windows for settlement of funds in JamClear-RTGS and settlement of securities in the JamClear-CSD, JCSO and the international custodian bank<sup>4</sup>.

## 3.0 OPERATIONAL REQUIREMENTS FOR THE RETAIL REPO TRANSACTION STRUCTURE

The requirements of the retail repo transaction structure are detailed as follows:

### 3.01 JamClear Systems Requirement

- a) The establishment of special settlement arrangements, namely dealer specific participant (DSP) accounts for each dealer engaged in the retail repo business as specified by the trustee and/or the FSC in JamClear-RTGS and JamClear-CSD;
- b) Special Bank Identification Codes will be issued for each DSP account by the BOJ instead of by SWIFT;
- c) Each DSP account must be able to settle in JMD and USD;
- d) Appropriate USD and JMD settlement arrangements will be established; and
- e) JamClear systems will provide straight through processing access to the trustee.

### 3.02 Trustee Requirements

- a) The trustee will be required to apply for a TRN for each DSP account with unique branch numbers to identify each dealer. These TRNs will be used to create the DSP accounts in JamClear-RTGS and JamClear-CSD;<sup>5</sup>
- b) The trustee will be required to open an account with an international custodian bank<sup>6</sup> to sub-custody global securities deposited in overseas depositories that will be underlying retail repo contracts;
- c) The trustee will establish message interface capabilities with the JamClear systems and the international custodian on a near-automated basis that allows the smooth transaction of dealer business;

---

<sup>4</sup> Dealers must upload all transaction files with large settlement balances, that is, values above a certain limit by an initial cut off time of 12p.m. Dealers will be allowed to upload files within a certain limit up to a final cut off time of 2p.m. All settlement of cash and securities must occur no later than 3p.m. Of note, if a dealer submits more than one file during the day, the first file must be settled prior to the settlement of all others. Additionally, each file will be processed and settled on an "all or none basis".

<sup>5</sup> The trustee needs a TRN for each dealer's client account to establish the fact that a transfer of title has occurred and that the trustee is the legal owner of the securities on behalf of the clients. Dealers can request securities portfolio statements from the trustee. With respect to coupon payments, dealers are required to provide payment instructions to the trustee in order to facilitate this. Additionally, the trustee will provide withholding tax certificates for all coupon payments received on behalf of the dealers.

<sup>6</sup> The due diligence process to establish this relationship is on-going. Once an international custodian is selected, this fact will be communicated to the industry.

- d) The trustee will be required to open dealers' client accounts in JCSD to maintain balances of immobilized securities underlying the retail repo contracts;
- e) The trustee will perform netting of both funds and securities based on the details in the transaction file uploaded by the dealers. Upon completion, the trustee will send a netting advice to each dealer;
- f) The trustee will maintain end of day securities prices for valuation purposes;
- g) The trustee will perform end of day reconciliations using balances of cash obligations/purchase price and the value of underlying securities held in the client accounts in the JamClear-CSD, JCSD and the international custodian bank, and send a report to each dealer; and
- h) The trustee's reconciliation and exception reports<sup>7</sup> will be provided to the FSC.

### 3.03 Dealer Requirements

- a) All securities underlying a retail repo contract must be immobilised<sup>8</sup> or dematerialised in approved CSDs;
- b) Dealers will be required to populate flat files containing transactions for retail repo clients in the format specified by the trustee and uploaded as per operating schedule. The fields for the flat file include the following:
  - i. JCSD account number
  - ii. account type
  - iii. investor's name
  - iv. address (if new account)
  - v. repo contract number
  - vi. transaction number
  - vii. transaction type/marker
  - viii. taxpayer registration number (TRN),<sup>9</sup>
  - ix. interest rate,
  - x. cash obligation/principal,
  - xi. currency of cash obligation
  - xii. exchange rate (for cross currency transactions)
  - xiii. purchase date
  - xiv. repurchase date/maturity date
  - xv. margin requirement amount
  - xvi. quantity of security
  - xvii. price of security
  - xviii. security value and
  - xix. International Securities Identification Number (ISIN) or other unique security identifier);
- c) Dealers will be required to validate each flat file of retail repo transactions using an application which will be provided by the trustee.
- d) New participants are required to complete the JCSD participant application process;

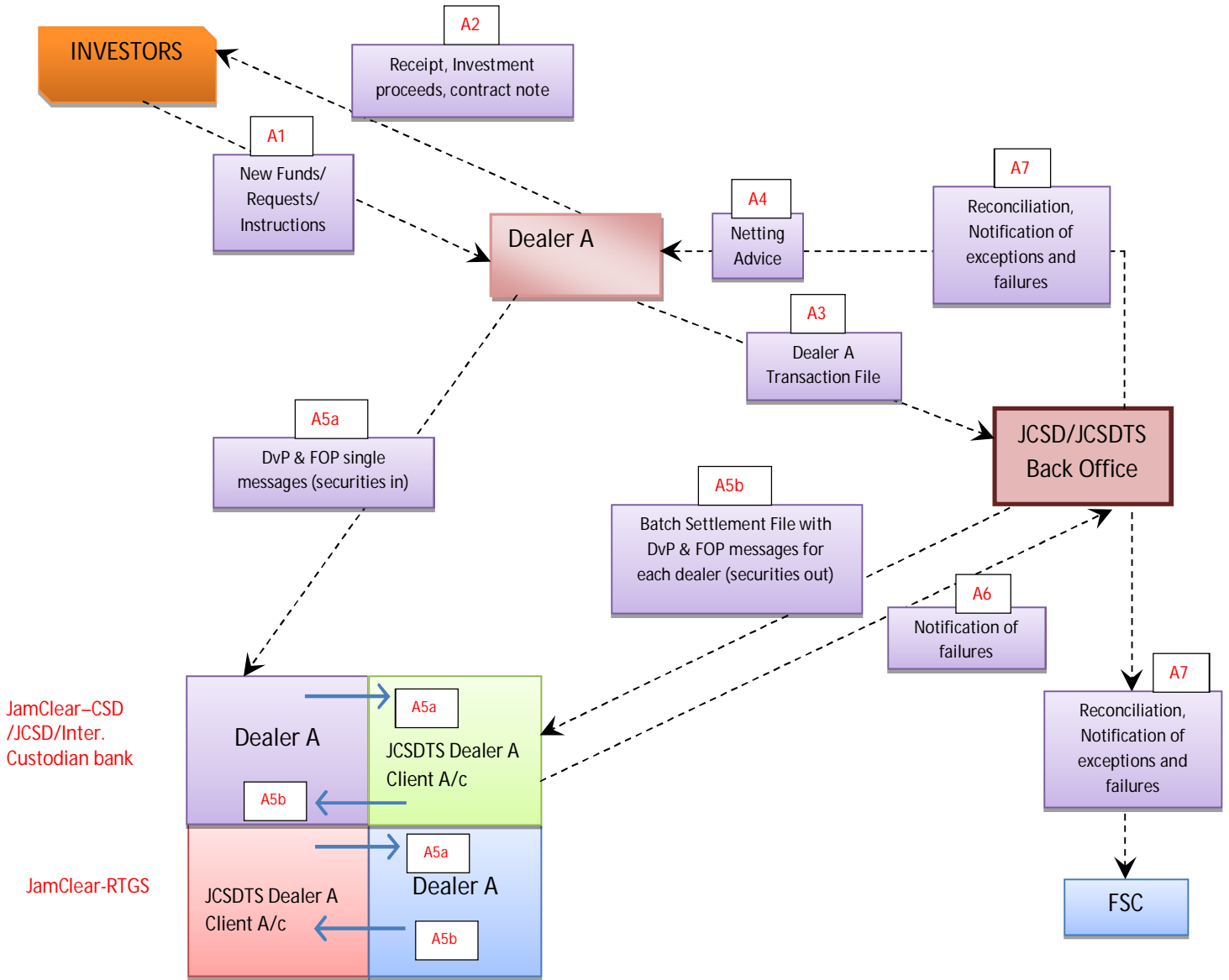
<sup>7</sup> A minimum requirement for clearing of exceptions is to be agreed and enforced as per operating rules and schedule.

<sup>8</sup> Approved securities must be immobilized in JCSD.

<sup>9</sup> Overseas clients who wish to transition the trust arrangement should apply for a TRN.

- e) Dealers' back offices will require some form of interface with the JCSD system. This can likely be facilitated through the utilization of flat files in a specified format to be uploaded to JCSD;
- f) Dealers will be required to open an account with JCSD for each retail repo investor.
- g) Dealers will be required to open dealers' own accounts in JCSD to maintain unencumbered/unallocated balances of immobilized securities.

4.0 OPERATIONAL PROCESS FLOW FOR RETAIL REPO TRANSACTION STRUCTURE





### A1 Description

1. Dealer A receives funds from investors for retail repo investment<sup>10</sup>.
2. For existing investors with contracts:
  - (i) Dealer A receives encashment requests (full, partial, early) from retail repo investors.
  - (ii) Dealer A's retail repo obligations mature and the investors have not made requests for encashment, thus the contracts will be rolled.

### A2 Description

1. Dealer A gives investors receipts outlining the terms of the agreement similar to the contract note with the exception of the details on the underlying securities.
2. Dealer A generates a contract note for new funds and roll overs and provides to investors after allocation of securities has occurred at A5a.
3. Dealer A prepares payment instructions and disburses funds to investors in conjunction with A5b.

### A3 Description

Dealer A prepares transaction details file with the required fields for the following retail repo transactions and uploads to the trustee for processing:

- (i) new funds
- (ii) encashments (partial, full, early)
- (iii) roll-overs
- (iv) substitutions

### A4 Description

The trustee performs netting of funds and securities per ISIN based on the details in the transaction file. Upon completion, the trustee prepares and sends netting advice to Dealer A to verify the amount of cash and/or securities required for settlement of the retail repo transactions. The dealer will use this to validate transactions.

### A5a Description

- a. For retail repos where the underlying securities are registered on JamClear-CSD, Dealer A and the trustee enter matching messages in JamClear-CSD to transfer securities from Dealer A's own account to the trustee's Dealer A client account.

If new funds exceed encashments, Dealer A and the trustee enter matching delivery versus payment (DvP) messages in JamClear-CSD. This will effect:

- (i) the transfer of securities from Dealer A's own account to trustee's Dealer A clients account in JamClear-CSD; and
- (ii) the transfer of cash from trustee's Dealer A client a/c<sup>11</sup> to Dealer A's participant account<sup>12</sup> in JamClear-RTGS.

---

<sup>10</sup> Investors are required to complete and sign a client opening form; a retail repo master repurchase agreement; a JCSO opening form and supporting know your customer documentation. Dealer A is required to deposit all new funds in its client account at a commercial bank.

Where additional securities are required for roll overs and/or substitution, Dealer A and the trustee enter matching free of payment (FOP) messages in JamClear-CSD to transfer the securities from Dealer A's own account to trustee's Dealer A client account.

- b. For retail repos where the underlying securities are not registered on JamClear-CSD, (global bonds sub-custody by the JCSD with an international custodian bank, or immobilized securities in JCSD), if new funds exceed encashment, Dealer A will instruct its overseas broker/custodian (global bonds) and JCSD (immobilized securities) to transfer securities from its own account to the trustee's Dealer A client account. Upon receipt of the securities, the trustee will transfer funds from the trustee's Dealer A client account to Dealer A participant account<sup>13</sup> in JamClear-RTGS.

#### A5b Description

- a. For retail repos where the underlying securities are registered on JamClear-CSD, Dealer A and the trustee enter matching messages in JamClear-CSD to transfer securities from trustee's Dealer A client account to Dealer A's own account.

If encashments exceed new funds, Dealer A and the trustee enter matching DvP messages in JamClear-CSD. This will effect:

- (i) the transfer of securities from trustee's Dealer A client account to Dealer A's own account in JamClear-CSD; and
- (ii) the transfer of cash from Dealer's A own account<sup>14</sup> to trustee's Dealer A client a/c in JamClear-RTGS.

To return substituted securities to Dealer A, the trustee enters an FOP message in JamClear-CSD to transfer the securities from trustee's Dealer A clients account to Dealer A's own account<sup>15</sup>.

- b. For retail repos where the underlying securities are not registered on JamClear-CSD, (global bonds sub-custody by the JCSD with an international custodian bank, or immobilized securities in JCSD), if encashment exceeds new funds, Dealer A will instruct its commercial bank to transfer funds to the trustee's Dealer A client account in JamClear-RTGS. Upon receipt of the funds, the trustee will instruct its overseas custodian/JCSD to transfer securities from trustee's Dealer A client account to Dealer A own account.

#### A6 Description

The trustee receives a notification of all failed transactions.

#### A7 Description

1. The trustee performs reconciliations of transaction details from dealer A's upload against securities held in trustee's Dealer A client account on JamClear-CSD/JCSD/international custodian bank to ensure that the

---

<sup>11</sup> Dealer A will be required to transfer the adequate funds from its client account at the commercial bank to facilitate settlement of transactions. At the end of each day, the account should be at zero balance, therefore, only funds to be used for settlement should be placed in this account.

<sup>12</sup> For secondary dealers, the funds will be transferred to its own account at the commercial bank.

<sup>13</sup> For secondary dealers, the funds will be transferred to its own account at the commercial bank.

<sup>14</sup> Secondary dealers will be required to settle using existing settlement arrangements in JamClear-RTGS through trading ceilings.

<sup>15</sup> This transfer will be executed once the replacement securities have been received in the trustee's Dealer A account.

value of securities transferred is adequate to cover cash obligation (principal) and the required margin (buffer). Upon completion, the following occurs:

- (i) For new funds, the transaction details (including cash obligation and the value of underlying securities inclusive of the required margin) are recorded by the trustee in each investor's account on JCSD.
  - (ii) For encashments, the transaction details (including cash obligation and the value of the underlying securities inclusive of the required margin) are updated by the trustee to reflect a reduced or zero balance in each investor's account on JCSD.
  - (iii) For roll-overs, the transaction details (including cash obligation and the value of underlying securities inclusive of the required margin) are updated by the trustee to reflect the new allocation in each investor's account on JCSD.
  - (iv) For substitution, the transaction details (including cash obligation and the value of the underlying securities inclusive of the required margin) are updated by the trustee to reflect the change in securities held in each investor's account on JCSD.
2. The trustee's reconciliation and exception reports will be provided to the dealers and also to the FSC.

## 5.0 TIMELINES

The legal and regulatory framework to support the new operational framework will be in place by December 31, 2014. Additionally, the transition of retail repos to the new operational framework will be finalized by end-June 2015 taking into account evolving market conditions while ensuring financial stability. As interim steps, a pilot will commence end-February 2015 while the transition will commence by mid-April 2015.

## 6.0 CONCLUDING REMARKS

The new transaction structure will enhance the current regulatory framework for the retail repo market. This is consistent with the FSC's commitment to protect the interests of investors. To ensure the achievement of this objective, the legal and operational frameworks associated with the trust arrangement embody the following characteristics:

- a) Transfer of legal ownership of underlying securities to the trustee
- b) De-segregation of assets in a third-party account
- c) Establishment of an express trust for the benefit of retail repo investors

For further information, kindly direct queries in writing to:

The Senior Director, Securities  
 Financial Services Commission  
 39-43 Barbados Avenue  
 Kingston 5, Jamaica, W.I.

Inquires may also be submitted by email to:

[securities@fscjamaica.org](mailto:securities@fscjamaica.org)