SR-GUID-18/09-0025

GUIDELINES FOR THE RETAIL REPO MISMATCH RATIO PRUDENTIAL BENCHMARK

The Financial Services Commission

39-43 Barbados Avenue Kingston 5, Jamaica

Telephone No. (876) 906-3010

September 28, 2018

FINANCIAL SERVICES COMMISSION

GUIDELINES FOR THE RETAIL REPO MISMATCH RATIO PRUDENTIAL BENCHMARK

September 28, 2018

1.0 BACKGROUND

1.01 The Securities (Prudential) Regulations, 2014, hereafter referred to as the Prudential Regulations, were enacted on December 30, 2014. These Prudential Regulations serve to strengthen the prudential supervision of the securities industry by the Financial Services Commission, hereafter referred to as the Commission. Regulation 18 of the Prudential Regulations requires that a licensee maintain all ratios specified by the Commission by written notice.

1.02 These guidelines on the Retail Repo Mismatch Ratio (RRMR) are being issued pursuant to Regulation 18 and follow on an industry consultation paper issued in December 2017 (SR-CONSUL-17/12-0030). The RRMR is aimed at monitoring and managing the level of intermediation risks, which arise primarily from duration and liquidity mismatches inherent in securities dealers' retail repo business.[1] The duration mismatch between retail repurchase agreement (repo) liabilities and long-term securities highlights the vulnerability of securities dealers to interest rate and liquidity shocks and has been identified as a source of systemic risk in the Jamaican financial system, thus necessitating the implementation of regulatory measures to monitor and control these risks.

1.03 The implementation of this ratio represents another phase in the retail repo reform, subsequent to the transition to the Trust-Based Framework established in 2015.

2.0 DEFINITIONS

2.01 For the purposes of these Guidelines, the following terms are defined:

"Prescribed deductions" has the same meaning as defined in the Securities (Prudential) Regulations, 2014

"Regulatory Capital" means Tier 1 and Tier 2 Capital, less prescribed deductions

"Retail Repurchase Agreements" has the same meaning as defined in the Securities (Retail Repurchase Agreements) Regulations, 2014

"Tier 1 Capital" has the same meaning as defined in the Securities (Prudential) Regulations, 2014

"Tier 2 Capital" has the same meaning as defined in the Securities (Prudential) Regulations, 2014

[1] The retail repo product is primarily used by securities dealers to finance their inventory of long-term securities, mainly Government of Jamaica (GOJ) securities, using shorter-term obligations with clients.

3.0 SCOPE

3.01 These Guidelines are applicable to all securities dealers licensed under the Securities Act who enter into and conduct repurchase agreements pursuant to the Securities (Retail Repurchase Agreements) Regulations, 2014.

4.0 THE RETAIL REPO MISMATCH RATIO (RRMR)

4.01 The RRMR directly indicates the degree to which the securities dealer's retail repo portfolio is exposed to the impact of movements in interest rates. The ratio effectively represents the potential percentage movement in the value of the retail repo assets for every percentage movement in interest rates.

4.02 Based on the structure of retail repo where interest and principal are made in a single payment at the end of the contract period, the duration and maturity for repo liabilities are identical.

5.0 CALCULATION

The RRMR is equal to [the weighted average duration of retail repo assets *Minus* the weighted average duration/maturity of retail repos liabilities] *Multiplied by* [Total retail repo liabilities *Divided by* Regulatory Capital] *Multiplied by* [total Retail Repo Liabilities *Divided by* total Retail Repo Assets (at market value)]

[{(WAD (retail repo assets) – WAD (retail repo liabilities))[2]* TRRL}/RC] * (TRRL/TRRA)

6.0 IMPLEMENTATION AND TRANSITION ARRANGEMENT OF THE PRUDENTIAL BENCHMARK

6.01 The FSC intends to ultimately apply a benchmark for the RRMR of no more than 15% by December 31, 2020. However, the FSC recognizes the need for an adequate period of adjustment to the implementation to these new prudential requirements. The timetable therefore comprises a three (3) year implementation plan which involves an early warning monitoring period from March 2018 to March 2020 followed by full implementation by end December 2020. The arrangements for implementation are outlined below:

6.02 The FSC will initially incorporate the RRMR ratio into its supervisory framework as an on-going Early Warning Indicator, which will enhance the prudential supervision of the relevant dealers. This will be achieved as follows:

a) Calculations of the ratio will be conducted by the securities dealers and the FSC on a quarterly basis. A template for the calculation will be provided by the FSC subsequent to the release of these Guidelines;

[2] The result of WAD (retail repo assets) – WAD (retail repo liabilities) should be divided by 100.

b) Monitoring will occur based on a range of between 15% and 20%. The ratio will be monitored for each securities dealer to determine divergence from and/or convergence to the proposed threshold of 15%;

c) Securities dealers that are above the 15% threshold as at June 30, 2018 are expected to remain at or below the RRMR level. Failure to do this will result in enhanced monitoring which may include but not limited to:

   i. Monthly RR mismatch analysis;

   ii. Request the submission of a Board approved action plan to promote convergence to proposed benchmark within an agreed timeframe;

   iii. Convening meetings with dealers to discuss concerns;

   iv. Enforcement actions if deemed necessary.

d) Where a securities dealer's RRMR level is above 20% as at June 30, 2018 the FSC will require that the securities dealer take actions to bring the RRMR to no more than 20% by June 30,2019;

e) After the March 2020 reporting date, any breach by securities dealers who are required to meet the applicable regulatory standard will result in regulatory actions being taken, according to established procedures;

6.03 Full Implementation will proceed as follows:

Implementation Date	Benchmark
March 31, 2020	20.00%
June 30, 2020	18.75%
September 30, 2020	17.50%
December 31, 2020	15.00%

6.04 In order to ensure full compliance on a continuing basis, the FSC will also adopt an early warning indicator of 13.5% effective January 1, 2021. Securities dealers will be required to report any breach of the 13.5% indicator to the FSC immediately and provide, within 30 days, a Board approved plan to ensure the securities dealer remains in compliance with the benchmark of 15%.

6.05 The phased implementation period will be reviewed on an on-going basis, taking into consideration other changes in the prudential framework.

6.06 During the transition period, in addition to monitoring the ratio for each securities dealer, several activities will be undertaken, including but not limited to:

a. Reassessment of the proposed benchmark on an on-going basis taking into consideration the potential impact of other changes in the supervisory process such as the introduction of a liquidity ratio and the implementation of large exposure limits.
b. Reviewing the current pool of allowable assets for retail repos

6.07 The FSC, in collaboration with the GOJ Debt Management Unit, will also monitor the securities dealers' level of participation in GOJ issues subsequent to the implementation notice. Any significant issues will be discussed by the two authorities as they arise, including any potential impact on the monitoring and implementation of the RRMR.