



**FINANCIAL SERVICES COMMISSION
DISCUSSION PAPER
A RECOMMENDED FINANCIAL DISCLOSURE STANDARD FOR SECURITIES
DEALERS
APRIL 15, 2005**

1.0 Background

- 1.1 Many Jamaican securities dealers presently engage in significant balance sheet intermediation. In particular, it is common practice for licensed securities dealers to hold large volumes of investments in securities financed by borrowing funds from their clients through the use of short-term repurchase agreements, instead of brokering securities to clients (i.e. selling such securities outright to clients). Given the degree of maturity mismatch between the investment assets of securities dealers and the repurchase liabilities that fund these investments, the level of balance sheet intermediation practiced by securities dealers exposes these entities to significant liquidity and interest rate risks.
- 1.2 The Financial Services Commission (“the Commission”), for prudential reasons, has recently sought to regulate the use of credit by licensed securities dealers. The Commission has issued guidelines, which: (a) prescribe margin requirements for repurchase agreements,¹ and (b) prescribe limits for margin borrowing by securities dealers from broker-dealers, usually overseas broker-dealers, to finance the acquisition of foreign currency assets.² These guidelines are currently being drafted into regulations. The Commission has also established the risk weights to be applied to assets and other risk exposures, and the minimum ratio of capital to risk weighted assets and exposures (or capital adequacy ratio). This development brings into effect a risk-based capital regime for securities dealers in keeping with the provisions introduced in the 2003 amendments to the Securities (Licensing and Registration) Regulations.³

¹ See Financial Services Commission “*Margin Requirements for Repurchase Agreements*” SR-GUID-04/07-0010, July 30, 2004. This paper and other Financial Services Commission papers cited below are available on the Commission’s website at: www.fscjamaica.org/securities.htm

² See Financial Services Commission “*Minimum Requirements for Client – Dealer Repurchase Agreements*” SR-GUID-04/07-0012, July 30, 2004.

³ See Financial Services Commission “*Guidelines for Interim Capital Standards for Securities Dealers*” SR-GUID-04/07-0011, July 30, 2004.

- 1.3 However, prudential supervision is only one dimension of the Commission's regulatory effort. Another dimension involves enhancing market discipline through increased investor awareness and education, underpinned by adequate public disclosure practices by relevant institutions. The purpose of this discussion paper is to elaborate a minimum standard of disclosure by securities dealers to clients to facilitate a more informed view of the potential risks and rewards involved in financial transactions with these dealers.

2.0 Objective

- 2.1 As part of its on-going commitment to improving public disclosure for investor protection and decision-making, the Commission has relied on a tradition that involves a balanced use of regulation and the encouragement of industry best practice. The regulatory dimension for public disclosure is embodied in various statutory reporting requirements to be found in financial sector statutes (the Securities Act and relevant regulations) as well as in broader statutory frameworks such as the Companies Act and laws in relation to anti-fraud, ethical codes and governance.
- 2.2 Recently, the Commission has sought to improve the regulatory oversight of public disclosure practices in the securities market, through the issuance of guidelines, which aim to improve compliance of reporting entities by clarifying the Commission's expectations of the content of disclosure documents.⁴ The Commission's efforts at encouraging industry best practice have included, among other things, the publication of a discussion paper outlining some general principles of a desirable disclosure framework for publicly listed companies and summarizing the expected disclosure responsibilities of various stakeholders.⁵
- 2.3 This discussion paper complements the Commission's efforts at encouraging best practice by clarifying the Commission's views on the minimum desired disclosure by securities dealers to their clients.

3.0 Minimum Disclosure Requirements for Securities Dealers

- 3.1 Principle 1 of the International Organization of Securities Commissions ("IOSCO") principles regarding disclosure states that "*Companies should have an ongoing disclosure obligation requiring disclosure of all information that would be material to an investor's investment decision.*" The proposed disclosure framework for securities dealers is shown schematically in Figure 1 below. Within this framework, there is a distinction between financial and non-financial disclosures.

⁴ See Financial Services Commission "*Securities Release: Management Discussion and Analysis (MD&A)*" SR-GUID-05/12-0004, January 9, 2003; See also Financial Services Commission "*Guidelines for Issuer of Securities*" SR-GUID-02/12-0005.

⁵ See Financial Services Commission "*Reshaping the Public Disclosure Framework – Regulation and Sustainable Embrace of Best Practice*" SR-GEN-04/11-0003, November 17, 2004.

- 3.2 Outlined in paragraph 3.3 below is the desired minimum standard for financial disclosures by securities dealers to its clients. For the purposes of the standard, a “**client**” means a party, not being a licensed dealer or regulated deposit taking institution, which purchases securities from a dealer under a repurchase agreement, as defined in paragraph 3.1 of the Commission’s guidelines on margin requirements for repurchase agreements.⁶
- 3.3 **As a standard of best practice of financial disclosure by securities dealers to their clients, all securities dealers who enter into repurchase agreements or otherwise borrow funds from clients should:**
- A. **Make readily available to all clients, the audited financial statements for the latest available year;**
 - B. **Make readily available to all clients, the latest available unaudited quarterly financial statements for the period subsequent to the date of the last audited statements, along with the Management Discussion and Analysis (MD&A) reports accompanying the quarterly statements;**
 - C. **Make this information available to all clients at the same time and in the same form as they are made available to the Commission, including the C1 form that is required for regulatory purposes. Each client should be advised of the availability and how to obtain a copy at the time of the release of the information.**

4.0 Conclusion

- 4.1 Securities dealers in Jamaica often engage in balance sheet intermediation activities that expose them to significant investment risks, beyond what would be normal for “pure” brokers. This paper has recommended a minimum standard of financial disclosure aimed at allowing the clients of securities dealers to more adequately assess these investment risks.
- 4.2 The Commission invites comments on the draft standard from interested parties. Comments and queries may be emailed to securities@fscjamaica.org or sent directly to the Senior Director, Securities, Financial Services Commission. All comments and queries should reach the FSC by **June 3, 2005**.

⁶ See the reference cited in footnote 1.

Figure 1: Minimum Public Disclosure for Securities Dealers

