

CENTRAL BANK OF LIBERIA



FINANCIAL MARKETS DEPARTMENT GUIDELINES NO. CBL/FMD/002/2018

GUIDELINES ON REPURCHASE AND REVERSE REPURCHASE AGREEMENTS

JANUARY 10, 2018

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PART A OVERVIEW

1. Introduction

Guidelines and Objectives

- 1.1 These guidelines on repurchase agreement (Repo) transactions are formulated in accordance with Section 39 (2) of the New Financial Institutions Act (FIA) in order to contribute to the development of the money market and aims to:
- a. set out the scope of Repo transactions that can be conducted by licensed banks;
 - b. promote sound risk management practices by licensed banks and particularly on credit risk, market risk, and settlement risk for the conduct of Repo transactions; and
 - c. protect investors by introducing requirements on the use of repurchase and reverse repurchase agreements by licensed banks.

Scope of Guidelines

- 1.2 These guidelines set out the applicable regulatory requirements and the CBL's expectations in relation to Repo transactions entered into by licensed banks among each other, with the CBL or other counterparties.

2. Applicability

- 2.1 These guidelines are applicable to all licensed banks.
- 2.2 These guidelines are applicable to dealings in Liberian Dollars and United States Dollars Repo and reversed Repo transactions including any outright sale or purchase of eligible securities (herein defined) with an intention to repurchase or resell these eligible securities at a future date. The substance of a transaction prevails over its form

in determining whether a transaction is governed under these guidelines.

3. Legal Provisions

3.1 The requirements in these guidelines document are specified pursuant to section 36 and 37 of the CBL Act 2000 and section 24 and 39 (2) of the FIA 1999.

4. Effective Date

4.1 These guidelines shall come into effect on January 10, 2018.

5. Definition and Interpretation

5.1 In these Guidelines, unless the context otherwise requires:

- A. If **S** is before a subsection, it denotes a standard requirement or specification to be complied with. Failure to comply may result in one or more enforcement actions;
- B. If **G** is before a subsection, it denotes guidance which may consist of such information advice or recommendation intended to promote common understanding and sound industry practices which are encouraged to be adopted;
- C. **Licensed Bank** means any person licensed by the CBL to engage in financial transactions consisting in the business of banking, the acceptance of deposits payable on demand and subject to transfer by check, credit, loan making, and lending or rendering non-banking financial services: unless the context otherwise requires, all offices and branches of a licensed bank in Liberia shall be deemed to be one institution.
- D. **Licensed Investment Bank** means any person or institution licensed by the appropriate regulatory body to participate in the capital markets (bond market and equity markets, for

instance) through the purchase and sales of large holdings of newly issued shares.

- E. **Classic Repo** means a type of Repo where eligible securities are sold against cash with a commitment to repurchase the equivalent eligible securities on a specified date at a specified price, where both date and price are fixed at the initiation of the transaction. The Repo Seller delivers eligible securities and receives cash from the Repo Buyer. The cash is supplied at the prevailing Repo rate that remains constant during the term of the transaction;
- F. **Cross Currency Repo** means a Repo transaction in one currency against eligible securities where the eligible securities and cash involved are denominated in different currencies;
- G. **Eligible Securities** mean securities eligible for a Repo transaction under this policy document as specified in section 8;
- H. **Held-in-Custody** means a Repo in which the Repo seller retains possession of the eligible securities, even though legal title passes to the Repo buyer;
- I. **Negotiable Instrument of Deposit (NID)** is an instrument issued by a banking institution certifying that a certain sum in local or foreign currency has been deposited with the issuing bank for a certain tenor at a specified rate of interest (coupon rate may be fixed, floating or zero). Unlike fixed deposit, it can be sold or negotiated but cannot be prematurely withdrawn before maturity.
- J. **SSSS** means the Script less Security Settlement System;
- K. **Principal** means a party to a Repo transaction who acts on its own behalf or who authorizes an agent to act on its behalf;
- L. **Rate** means the rate of interest on the cash leg in a Repo transaction expressed in a percentage;

- M. **RTGS** means Real Time Gross Settlement System;
- N. **Repo** means a sale of eligible securities and a simultaneous agreement to repurchase the equivalent eligible securities on a future date at the original price plus a rate of return on the use of the cash. Repo shall include both Repo and reverse Repo, cross currency Repo and, unless otherwise mentioned, covers both Classic Repo and Sell Buy-Back transactions regardless whether the eligible securities is delivered-out or held-in-custody;
- O. **Repo Buyer** means the party who purchases eligible securities for the term of the transaction and agrees to sell back equivalent eligible securities at maturity and earns a Repo rate on the transaction;
- P. **Repo Seller** means the party who sells eligible securities for cash for the term of the transaction and agrees to buy back the equivalent eligible securities at maturity and has to pay a Repo rate to the Repo Buyer;
- Q. **Reverse Repo** means a Repo transaction from the view of the Repo Buyer i.e. the party who is purchasing the eligible securities; and
- R. **Sell/Buy-Back** means a type of Repo with an outright sale of eligible securities on the value date at spot price and a simultaneous outright buy back of the equivalent eligible securities for value on a forward date. The Repo Rate and any coupon income accrued during the term of the transaction on the nominal amount of the eligible securities are embedded in the forward price and realized at the maturity of the transaction.
- S. **Mark To Market, or Marking to Market** is when asset values are determined "according to market prices" at the end of each day in order to arrive at the profit or loss status of the parties in a futures transaction.

T. Standard & Poor Global Credit Rating

BBB is a long term issue obligation rated that exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

A-3 is a short-term obligation that exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

U. Moody's Credit Rating

Baa3 is the lowest rating of investment grade for Moody's long-term corporate obligation. Obligations rated Baa3 are subject to moderate credit risk. They are considered medium grade and as such may possess certain speculative characteristics.

P-3 is the lowest rating of investment grade for Moody's short-term obligation. Issuers (or supporting institutions) rated Prime – 3 have an acceptable ability to repay short-term obligations.

V. Fitch's Credit Rating

BBB- is a good long-term credit quality. 'BBB-' ratings indicate that expectations of default risk are currently low. The capacity for payment of financial commitments is considered adequate, but adverse business or economic conditions are more likely to impair this capacity

F3 is a fair short-term credit quality. The intrinsic capacity for timely payment of financial commitments is adequate.

PART B REQUIREMENTS

6. General Requirements

- 6.1 **G** The conduct of Repo transactions should be in line with the principle of maintaining market integrity in order for the Repo market to operate in a sound and orderly manner.
- 6.2 **S** Licensed banks shall not in any circumstance enter into Repo transactions which limit the availability of eligible securities with the intention of creating a false or distorted market in Repo and the underlying eligible securities.
- 6.3 **S** At least one Principal to a Repo transaction shall be a licensed bank.
- 6.4 **S** The legal ownership of the eligible securities shall be transferred from the Repo Seller to the Repo Buyer for all Repo transactions.
- 6.5 **S** The Repo Buyer shall receive any coupon payment over the securities used in a repo transaction during the span of his ownership, but shall immediately transfer any such payment received to the repo seller.
- 6.6 **S** The maximum tenure of a Repo is **180 days**.
- 6.7 **G** Licensed banks who wish to transact a Repo should specify the amount when requesting for, or providing, quotes.
- 6.8 **S** Prior to undertaking Repo transactions, licensed banks shall ensure the following:
- (a) Only designated officers of licensed banks shall undertake Repo transactions;
 - (b) Adequate policies, procedures and internal controls are established to ensure that all Repo transactions are properly authorized and followed through up to maturity;

- (c) Depending on the scale of its Repo activities, effective coordination between the related functional areas to support its Repo activities including process for securities valuation and management, credit control, risk management and record keeping purposes;
- (d) There are adequate and effective documentation to cover the types of Repo transactions that are intended to be undertaken;
- (e) Any deviation from the normal Repo market conventions or any other arrangements that would need to be mutually agreed between counterparties should be properly documented in the legal agreement;
- (f) The names and identities of parties to a Repo transaction should be treated by licensed banks as confidential at all times; and
- (g) All relevant legal instruments and policy documents are complied with on a continuous basis.

7. Eligible Securities

7.1 **S** Liberian Dollars denominated securities eligible for Repo transactions comprise the following:

- (a) Securities issued by the Government of Liberia;
- (b) Securities issued by the Central Bank of Liberia;
- (c) Banker's Acceptances; and
- (d) Negotiable Instrument of Deposit

7.2 **S** Non-Liberian Dollars denominated securities eligible for Repo transactions comprise the following:

- (a) Securities issued by the Government of Liberia;
- (b) Securities (both sovereign and foreign corporate issuances) with at least Baa3/BBB-/F3/A-3/P-3 long-term and short-term international rating from Fitch Ratings, Inc., Standard & Poor's Rating Services, Inc. and Moody's Investor Services, Inc.; and

- (c) **Negotiable Instrument of Deposit issued by banks licensed in Liberia.**

7.3 **S** The abovementioned eligible securities used for Repo must not be convertible at the inception of the Repo transaction. This includes all Repo transactions rolled over or renewed on or after the effective date of these guidelines.

8. Legal Agreement

8.1 **S** All Liberian Dollars and non-Liberian Dollars Repo transactions shall be concluded through a binding agreement that specify all terms of the transaction, duties and obligations between the parties concerned.

8.2 **S** The agreement shall be subject to the laws of Liberia for Repo transactions. At minimum, the agreement should provide for:

- (a) the absolute transfer of title of the eligible securities including any eligible securities transferred through substitution or mark-to-market adjustment;
- (b) income payments on purchased securities and transfers;
- (c) marking-to-market of transactions, where applicable;
- (d) use of haircut and margin maintenance whenever the mark-to-market reveals material change in value;
- (e) events of default and the consequential rights and obligations of the parties to the transactions;
- (f) full set off of claims between the parties to the transaction in the event of default; and
- (g) the rights of the parties regarding substitution of eligible securities and the treatment of coupon payments in respect of the eligible securities subject to it, including for example, the timing of payments.

9. Custody

- 9.1 **S** All GoL and CBL securities used as collateral in a repo transaction shall be maintained under the CBL's custody arrangements in the SSSS.
- 9.2 **S** Licensed banks shall set up an appropriate custody arrangement for all other eligible securities held in its custody on behalf of its counterparty in a Repo transaction. Adequate procedures and systems should be established to segregate and monitor the eligible securities held-in-custody to avoid the risk of duplicative use of securities. Licensed banks and licensed investment banks shall ensure that these areas of systems and controls are subject to independent risk assessment.
- 9.3 **S** The terms and conditions set out in the custodian agreement including its consequential rights and obligations should be made clear to its counterparty prior to entering into any Repo transaction under such custody arrangement.
- 9.4 **S** Eligible securities held-in-custody shall not be re-hypothecated by the Repo seller during the term of the Repo. However, subject to adequate legal provisions in the agreement, the eligible securities may be substituted with equivalent securities as may be mutually agreed between both parties subject to the eligibility criteria of securities under paragraph 8 of these guidelines.

10. Risk Management

- 10.1 **S** Licensed banks shall formulate and implement appropriate risk management measures to address risks arising out of Repo transactions. These measures must include adopting risk mitigation techniques which involve the use of prudent haircuts, margin maintenance and timely margin call to maintain effective control of risk exposure.
- 10.2 **S** Licensed banks shall establish an exposure limit on their counterparties based on their credit assessment. Licensed banks and

licensed investment banks should exercise judgement in ensuring the review of exposure limits on a regular basis.

- 10.3 **S** Licensed banks and licensed investment banks shall apply suitable assessment on the creditworthiness of their counterparty and monitor their net counterparties exposure on a regular basis.

Credit and Market Risk of Eligible Securities

- 10.4 **S** Licensed banks and licensed investment banks shall negotiate and apply suitable haircuts that reflect its assessment on the credit and market risks of the eligible securities (e.g. duration and liquidity) involved in the Repo transaction.

- 10.5 **S** Eligible securities received via Repo transactions shall be marked-to-market, if the market price of the security has been established, on a daily basis when necessary as frequent as possible particularly if there has been a large movement in the market within the day. In the event that readily available sources of valuation is lacking, licensed banks shall maintain the historic value of the security for the duration of the repo transaction.

- 10.6 **S** Whenever a marked-to-market valuation reveals a significant exposure to its counterparty, over and above any agreed margin threshold, licensed banks shall initiate a margin call (either in the form of cash or securities) promptly to restore the initial position. The form of margin should be specified in the agreement entered into between both parties.

Settlement Risk

- 10.7 **S** Licensed banks shall minimize settlement risk for all Repo transactions.

11. Reporting and Settlement Requirements

- 11.1 **S** For all repo transactions involving GoL and CBL securities, licensed banks shall report to the Financial Markets Department on the day

the transaction is concealed and the day it is reversed for the appropriate transfer and settlement to be performed in the SSSS.

- 11.2 S** Repo transactions involving GoL and CBL securities as collateral, and/or margin transfer shall be settled through the SSSS.
- 11.3 G** Cash margin should be transferred via RTGS or any other mode of fund transfer as agreed by the parties to the Repo transaction.
- 11.4 S** For all eligible securities, licensed banks shall disclose the details of the Repo transactions in the following statements of financial position – short term securities, bonds and long term securities, and other long term securities through the vRegCoSS.

Appendix 1.

COMPARATIVE CREDIT RATINGS						
Moody's		S&P		Fitch		Rating description
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term	
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime
Aa1		AA+		AA+		High grade
Aa2		AA		AA		
Aa3		AA-		AA-		
A1	P-2	A+	A-1	A+	F1	Upper medium grade
A2		A		A		
A3		A-		A-		F2
Baa1	BBB+	A-2	BBB+	Lower medium grade		
Baa2	BBB		BBB			
Baa3	P-3	BBB-	A-3		BBB-	F3
Ba1	Not Prime	BB+	B	BB+	B	Non-investment grade speculative
Ba2		BB		BB		
Ba3		BB-		BB-		
B1		B+		B+		Highly speculative
B2		B		B		
B3		B-		B-		
Caa1		CCC+		C		
Caa2	CCC	CCC				
Caa3	CCC-	CCC-				
Ca	CC	CC	Extremely speculative			
	C	C				
C	RD	DDD			Default imminent	
/	SD	DD	D			
/	D	D				