

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

# Repurchase Agreement Transactions

Issued on: 2 December 2014

# TABLE OF CONTENTS

**PART A Overview ..... 1**

1. Introduction ..... 1
2. Applicability ..... 1
3. Legal Provisions ..... 1
4. Effective Date ..... 2
5. Interpretation ..... 2
6. Related Legal Instruments and Policy Documents ..... 4
7. Policy Document Superseded ..... 4

**PART B Policy Requirements ..... 5**

8. General Requirements ..... 5
9. Eligible Securities ..... 6
10. Legal Agreement ..... 7
11. Custody ..... 7
12. Risk Management ..... 8
13. Foreign Exchange Administration Rules ..... 9
14. Reporting and Settlement Requirements ..... 9

# PART A OVERVIEW

## 1. Introduction

### Policy Objective

1.1. The policy document on repurchase agreement (Repo) transactions aims to -
(a) set out the scope of Repo transactions that can be conducted by licensed banks and licensed investment banks; and
(b) promote sound risk management practices by licensed banks and licensed investment banks particularly on credit risk, market risk, counterparty risk and settlement risk for the conduct of Repo transactions.

### Scope of Policy

1.2. This policy document sets out the applicable regulatory requirements and the Bank's expectations in relation to Repo transactions entered into by licensed banks and licensed investment banks among each other or with other counterparties.

## 2. Applicability

2.1. This policy document is applicable to all market participants which are licensed banks and licensed investment banks.

2.2. This policy document is applicable to dealings of Ringgit and non-Ringgit Repo and reverse 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 this policy document.

## 3. Legal Provisions

3.1. The requirements in this policy document are specified pursuant to section 140(1) of the Financial Services Act 2013 (FSA).

## 4. Effective Date

4.1. This policy document shall come into effect on 2 December 2014 ("effective date").

## 5. Interpretation

5.1. The terms and expressions in this policy document shall have the same meaning assigned to them in the FSA unless otherwise defined in this document.

5.2. For the purposes of this policy document:

**"S"** denotes a standard, requirement or specification to be complied with. Failure to comply may result in one or more enforcement actions;

**"G"** 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;

**"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;

**"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;

**"Eligible Securities"** mean securities eligible for a Repo transaction under this policy document as specified in paragraph 9;

**"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;

**"MARC"** means Malaysian Rating Corporation Berhad;

**"MyClear"** means the Malaysian Electronic Clearing Corporation Sdn Bhd;

**"Principal"** means a party to a Repo transaction who acts on its own behalf or who authorises an agent to act on its behalf;

**"Private Debt Securities (PDS)"** means debentures as defined under section 2(1) of the Capital Market and Services Act 2007 but do not include structured products or debentures issued by the Federal Government, any State Government or the Bank;

**"RAM"** means RAM Rating Services Berhad;

**"Rate"** means the rate of interest on the cash leg in a Repo transaction expressed in a percentage;

**"RENTAS"** means Real Time Electronic Transfer of Funds and Securities System, which is the real time electronic funds and securities transfer settlement system operated by MyClear;

**"RENTAS Securities"** means eligible securities deposited under RENTAS;

**"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;

**"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;

**"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;

**"Reverse Repo"** means a Repo transaction from the view of the Repo Buyer i.e. the party who is purchasing the eligible securities; and

**"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 realised at the maturity of the transaction.

## 6. Related Legal Instruments and Policy Documents

6.1. This policy document must be read together with the following:

(a) Participation and Operation Rules for Payments and Securities Services issued by MyClear;
(b) Operational Procedures for Malaysian Ringgit Settlement in RENTAS issued by MyClear;
(c) Operational Procedures for Foreign Currency Settlement in RENTAS issued by MyClear;
(d) Operational Procedures for Securities Services issued by MyClear;
(e) Malaysian Code of Conduct for Principals and Brokers in the Wholesale Money and Foreign Exchange Markets issued by the Bank together with the ACI Model Code with Malaysia's local addendum issued by Persatuan Pasaran Kewangan Malaysia (PPKM);
(f) Regulated Short-Selling of Securities in the Wholesale Money Market;
(g) Market Risk Capital Adequacy Framework;
(h) Liquidity Framework; and
(i) Foreign Exchange Administration Rules.

## 7. Policy Document Superseded

7.1. This policy document supersedes the Guidance Notes on Repurchase Agreement Transactions issued on 21 July 2006.

## PART B POLICY REQUIREMENTS

### 8. General Requirements

**G** 8.1. The conduct of Repo transactions should be in line with the principle of maintaining market professionalism and integrity in order for the Repo market to operate in a sound and orderly manner.

**S** 8.2. Licensed banks and licensed investment banks shall not in any circumstances 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.

**S** 8.3. At least one Principal to a Repo transaction shall be a licensed bank or licensed investment bank.

**S** 8.4. The legal ownership of the eligible securities shall be transferred from the Repo Seller to the Repo Buyer for all Repo transactions.

**S** 8.5. The maximum tenure of a Repo is 365 days.

**G** 8.6. The standard lot for an inter-bank Ringgit Repo is RM1 million and the minimum market lot for Ringgit Repo is RM100,000. Transactions involving non-Ringgit Repo should observe the standard and minimum market lots practised in the relevant markets. Licensed banks and licensed investment banks who wish to transact a Repo for a different amount should specify the amount when requesting for, or providing, quotes.

**S** 8.7. Prior to undertaking Repo transactions, licensed banks and licensed investment banks shall ensure the following:

(a) Only designated officers of licensed banks and licensed investment banks shall undertake Repo transactions;

(b) Adequate policies, procedures and internal controls are established to ensure that any Repo transactions have been properly authorised;

(c) Depending on the scale of its Repo activities, effective coordination between the related functional areas and appropriate infrastructure should be put in place by the management of the licensed bank or licensed investment bank to support its Repo activities including systems for securities valuation and management, credit control, risk management and record keeping purposes;

(d) Unless held under a custody arrangement, eligible securities of a Repo transaction shall be held independent from the counterparty;

(e) There are adequate and effective documentation to cover the types of Repo

transactions that are intended to be undertaken;

(f) 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;

(g) The names and identities of parties to a Repo transaction should be treated by licensed banks and licensed investment banks as confidential at all times; and

(h) All relevant legal instruments and policy documents are complied with on a continuous basis.

## 9. Eligible Securities

**S** 9.1. Ringgit-denominated securities eligible for Repo transactions comprise the following:

(a) Securities issued by the Government of Malaysia;

(b) Securities issued by the Bank;

(c) Private Debt Securities with at least BBB/P3/MARC-3 domestic ratings as defined by RAM and MARC;

(d) Negotiable Instruments of Deposit; and

(e) Banker's Acceptances.

**S** 9.2. Non-Ringgit denominated securities eligible for Repo transactions comprise the following:

(a) Securities issued by the Government of Malaysia;

(b) Securities issued by the International Islamic Liquidity Management Corporation;

(c) Securities (both sovereign and corporate issuances) with at least Baa/BBB/F3/A-3/P-3 international rating as defined by Fitch Ratings, Inc., Standard & Poor's Rating Services, Inc. and Moody's Investor Services, Inc.;

(d) Private Debt Securities with at least BBB/P3/MARC-3 domestic ratings as defined by RAM and MARC; and

(e) Negotiable Instruments of Deposit.

The abovementioned eligible securities include both conventional and its Islamic equivalent. However, the securities used for Repo must not be convertible at the inception of the Repo transaction.

## 10. Legal Agreement

**S** 10.1. All Ringgit and non-Ringgit Repo transactions[1] shall be subject to the Global Master Repurchase Agreement (GMRA) that specify all terms of the transaction, duties and obligations between the parties concerned. All Repo transactions with Ringgit securities subject to the GMRA shall adopt the Malaysian Annex issued by PPKM.

**S** 10.2. The agreement shall be subject to a governing law agreed by the counterparties. 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) marking-to-market of transactions;
(c) use of haircut and margin maintenance whenever the mark-to-market reveals material change in value;
(d) events of default and the consequential rights and obligations of the parties to the transactions including provision on close-out netting;
(e) full set off of claims between the parties to the transaction in the event of default; and
(f) 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.

## 11. Custody

**S** 11.1. Licensed banks and licensed investment banks shall set up an appropriate custody arrangement for the 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.

**S** 11.2. 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.

**S** 11.3. 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

[1] This includes all Repo transactions rolled over or renewed on or after the effective date.

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 9 of this policy document.

## 12. Risk Management

**S** 12.1. Licensed banks and licensed investment 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.

**S** 12.2. Licensed banks and licensed investment 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.

**S** 12.3. Licensed banks and licensed investment banks shall apply suitable assessment on the creditworthiness of their counterparty and monitor their net counterparties exposure on a daily basis.

### Credit and Market Risk of Eligible Securities

**S** 12.4. 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.

**S** 12.5. Eligible securities received via Repo transactions shall be marked-to-market on a daily basis or 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 and licensed investment banks may adopt alternative valuation methodologies subject to compliance with the principles of valuation methodologies outlined in the Market Risk Capital Adequacy Framework issued by the Bank.

**S** 12.6. Whenever a marked-to-market valuation reveals a significant exposure to its counterparty, over and above any agreed margin threshold, licensed banks and licensed investment 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**

**S** 12.7. Licensed banks and licensed investment banks shall minimise settlement risk for all Repo transactions.

## 13. Foreign Exchange Administration Rules

**S** 13.1. Reverse Repo transactions by licensed banks and licensed investment banks shall comply with the prevailing Foreign Exchange Administration rules on borrowing by resident and non-resident.

**S** 13.2. Hedging of Ringgit-denominated eligible securities arising from Repo transactions shall comply with the prevailing Foreign Exchange Administration rules on buying or selling of currency.

**G** 13.3. Foreign Exchange Administration rules are available from the Bank's website (http://www.bnm.gov.my/fxadmin).

## 14. Reporting and Settlement Requirements

**S** 14.1. For all RENTAS securities, licensed banks and licensed investment banks shall report to Bursa Malaysia Electronic Trading Platform.

**S** 14.2. Repo transactions involving RENTAS securities as collateral, collateral for substitution and/or margin transfer shall be settled through RENTAS.

**G** 14.3. Cash margin should be transferred via RENTAS or any other mode of fund transfer as agreed by the parties to the Repo transaction.

**S** 14.4. For both RENTAS and non-RENTAS eligible securities, licensed banks and licensed investment banks shall disclose the details of the Repo transactions in the Bank's Statistical Mart for Analysis and Reporting (STATSmart).