

MINUTES

HEADING: JSE EQUITY TRADING ADVISORY COMMITTEE MEETING

Date: 20 March 2018

Time: 10:00 to 12:00

Venue: JSE, Serengeti Boardroom – 9th Floor

Present:

Ms Donna Nemer (Chairman, JSE) (DN)
Mr Langa Manqele (LM)
Mr Merlin Rajah (MR)
Ms Pumelele Sibisi (PS)
Ms Leanne Parsons (LP)
Mr Tyrone Arendse (TA)
Ms Adele Hattingh (AH)
Mr Martin Koch (MK)
Mr Godfrey Matjuda (GM)
Mr Neil Cohen
Mr Cameron Macklin
Mr Alphonso Raats
Mr Warren Chapman
Mr Will Ridge
Mr Ockie Raubenheimer
Ms Erica Bruce
Mr Dharmesh Gangaram
Mr Rudolph Botha (Dial in)
Ms Lana Stacey (Dial in)
Ms Jackie Tetlow (Dial in)
Mr Philip van der Merwe (Dial in)

Apologies:

Mr Alec Schoeman
Mr James Stewart
Mr Harry Ioannou
Ms Sunette Mulder

Mr Mike Ray

Distribution: Equity Trading Advisory Committee

1. WELCOME, APOLOGIES & NEW MEMBERS

DN welcomed everyone to the first Equity Trading Advisory Committee meeting for 2018.

2. CONFIRMATION OF PREVIOUS MINUTES

The minutes of the previous TAC meeting were confirmed and accepted as correct.

3. ITAC PROJECT UPDATE

LP informed the committee that the timely and efficient delivery of the ITAC project has been largely supported by the market as no major investment or development has taken place in the derivatives markets for a number of years. The JSE has been busy with mandatory clearing member testing (MCMT) to ensure consistency of post trade activities before bringing the entire market into this testing. The MCMT cycle 2 testing was rescheduled, as agreed with clearing members to run from 5th March to the 16th March 2018 as an end-to-end testing with full position take-on. With current MCMT cycle 2 testing, there have been some challenges relating to clearing member software not performing to the required standard, and also not working efficiently enough to engage the entire market for testing. She informed the committee that there has been a breakthrough where the clearing members and the only selected clearing solution software provider agreed to establish a collaborative task force. Together with the JSE, this collaborative task force is collocated at the JSE and will take an agile and iterative approach in addressing issues together that come up in the testing phases.

The next mandatory market facing dress rehearsal (MMDR) which is mandatory for trading members, software providers and all shared infrastructure providers (SIPs) is scheduled for Saturday, 24 March 2018. The MMDR is a functional testing session that will simulate the normal production trading day. It is about testing all business processes impacted by the new solutions such as orders, trades and deal management functions to verify the outcome of the results on all screens and reports including any downstream integration etc. The trading members should note that it is not a high volume testing but a test that focuses on verifying integrity and accuracy. LP advised the trading members that the upcoming dress rehearsal on the 24th March 2018 is the last opportunity for trading members to test with multiple software providers as they need to finalise their choices to ensure sufficient time for roll out and readiness within their organisations. The dress rehearsal testing emphasis is mainly about testing connectivity with the JSE or SIPs, ensuring their chosen software meets their business requirements and to familiarise themselves with chosen solutions/front ends.

To date there have been three categories of issues raised:

- Commissions functionality
- Market Making,

- Deal Management

Software providers have informed the JSE that they have fixed bugs relating to commissions and deal management. This means that the trading member can test on CTS prior to the upcoming dress rehearsal testing or even post that. Regarding market making functionality, the JSE has asked members to engage with their software providers to find out how it would function in an ITAC world and how they could test this in CTS.

The JSE is willing to help trading members that come forward for assistance with specific individual software provider but will not be able to choose software providers for trading members.

The JSE implemented the cost assistance programme and credits on members' invoices commenced end Jan 2018.

The JSE will send the test pack check list to compliance offices and ITaC responsible officers a week prior to dress rehearsal testing and would also request feedback from members post testing. LP mentioned that trading members do not pay for CTS and members need to engage with their software providers to be able to test in CTS. LP informed the committee that some of terminology will be changing in ITAC go-live therefore additional documents will be sent out to trading members to assist with client education and readiness.

It was noted that the go-live date is highly depended on the dress rehearsal outcome and the result of MCMT. The JSE will engage with clients on a targeted go-live date during April 2018.

She then highlighted a recent issue that the JSE has identified which seems to be a market wide issue where participants are doing on-book trading; that there is a requirement to have another reference field to tie back transactions for offshore participants. For off-book trading, there are already two reference fields but for on-book trading there is only one substantially longer field. Market participants are using this field for various reasons and this has caused difficulty in tying back transactions, particularly for offshore clients that are trading through an execution only or prime broker where allocation instructions are then given to the clearing member. The JSE believes that this is an issue where the JSE might have to make API changes, however software providers should also be able to provide a solution. LP informed the committee that, that is the only recent market wide issue that has been highlighted.

LP concluded by notifying the committee that one of the benefits of ITAC is the ability to post securities as collateral, which will not be mandatory for all market participants. She stated that the trick in this process is that there are various stakeholders that will be affected such as STRATE, Asset Managers and CSDPs etc. The JSE is communicating with clearing members around the appropriate timing for implementation and will revert to the wider market with regards to the most efficient time to implement the securities collateral solution.

A committee member made a comment that if the JSE delays implementing securities collateral; it runs the risk of other projects overshadowing this project and thus, securities collateral going on the back-burner. LP assured the committee member that the JSE is taking proactive steps to ensure that there is a clear timeline so that those stakeholders that want to push this can do so and the implementation is not at the pace of the slowest stakeholder.

A question was then raised as to whether there are any plans for MillenniumIT (MIT) upgrades on the Cash Equities market. LP confirmed that there are no planned changes that are directly related to ITaC as these have already been made. The only aspect would be to ensure that none of the changes made on the derivatives market will affect the cash equities market. As a result of having to freeze the code base for ITaC, the JSE is however a few versions behind in terms of MIT releases; including some of the updates that take care of some of the fields that are required under MIFID. The JSE is looking to upgrade its MIT system either later this year or early next year.

4. CHANGES TO BLOCK TRADE REQUIREMENTS

Members were referred to Market Notice 23A/2018 advising members that the Registrar of Securities Services has, in terms of section 71(3)(c) of the Financial Markets Act, approved the amendments to the Equities rules and these together with the approved amendments to the Equities directives. The change is a revision to the parameters that determine the minimum size and therefore eligibility of Block Trades and Off Order Book Principal Trades for submission to the JSE Equities trading system.

MR mentioned to the committee he would like to go through all the Order and Trade type changes that were made late 2017 as well as the Block Trade Methodology change made in February 2018. There were a number of changes made which impacted the Pegged Hidden Order, End of day volume Auction, Block Trade, Cross Trade (XT) and the Off Order Book Principal (OP) trade type. The Minimum Reserve Size (MRS) was changed to reflect a notional of R10mil reflected as number of shares. The MRS calculation uses R10mil divided by the instruments previous day's closing price to provide the number of shares that would equate to MRS. This change impacted the Pegged Hidden Order functionality and the End of day volume auction as both pieces of functionality make use of the MRS requirement. MR also advised the committee that the JSE is working closely with their IT vendor to find a suitable mechanism to allow for a 2min window period for the XT functionality. The Block Trade methodology change was done in February 2018 and it saw a significant reduction in the minimum requirement for such trades. The implementation went smoothly with the EMS value still being updated in the Instruments Equity file, which is now shown as a value and not number of shares. This value now becomes the minimum for local members using the OP functionality as well. Members are advised to take note that the value reflected is in South African cents and not in SA rands.

In order for a transaction in an equity security to qualify to be submitted to the JSE equities trading system as a Block Trade in terms of rule 6.40.2, or an Off Order Book Principal Trade in terms of rule 6.40.8, the transaction must comprise of at least the following specified values, based on the segment to which the equity security is allocated

Segment requirements:

ZA01

The lower of –

30% of the average daily value, subject to a minimum of R10 million; or a nominal value of R100 million

ZA02

The lower of –

30% of the average daily value, subject to a minimum of R5 million; or a nominal value of R100 million

All other segments –

30% of the average daily value, subject to a minimum of R1 million

5. OD TRADE ACTIVITY AND RULE CHANGES

OD Trade definition

A delta trade is a transaction where a member trades as an agent or a principal in a single equity security where the transaction transfers the delta hedge:

- 6.40.4.1 from one member to another member; or
- 6.40.4.2 from a client of a member to that member; or
- 6.40.4.3 from a client of a member to another member.

in respect of a derivative transaction which has been reported to either the JSE derivatives trading system or the derivative trade recording system referred to in the directives.

Background on Zero Fees for OD Trades

The JSE, along with the market, agreed to zero fee the OD trade type in January 2016 to avoid a the duplicate charge. The zero fee process is an automated and upfront process; there is no validation of OD Trade against the OD Trade definition prior to applying a zero fee. This automated and upfront zero fee process is not a common JSE practice, other booking fees are charged first and upon a member's request, a zero fee would be applied after checking the qualification criteria.

Auditor's review

The automated and upfront zero fee has been flagged by our external auditors as a concern that the JSE has no controls in place to ensure that a zero fee is applied to OD trades that strictly meet the OD trade definition. The auditors have recommended that the JSE puts measures to validate the accurate use of the OD trade type and conduct regular commercial audits on the process.

Next Steps

- Update current OD definition and Zero Fee parameters
- Members to send JSE a monthly report on OD trades that warrant a Zero Fee.

Required information:

- The JSE ticker
- OD trade details
- Derivative trade details.
- Original Stock trade details
- Original Stock Trade ≤ 48 Hours

The information will be collected and analysed to establish whether the function is used correctly. If a member is not using the function correctly, the JSE would in turn charge the required fees to the member.

It was raised by a committee member that JSE members should be more concerned about being in contravention of the JSE rules rather than whether they had paid fees or not. Committee members also raised that there would be additional resources required to send through the information and would need to discuss with the JSE on how to best archive this function. A working group will be setup with members to discuss the OD trade type rule and how best to validate the use of the function.

6. UPDATE ON THE EQUITY TIERED BILLING MODEL

DN provided the committee with an update on the Equity Market Tiered billing model. She informed the committee that the JSE has conducted market consultations and most participants are in favour of a tiered billing model. The JSE has thereafter reviewed the model in line with consultation feedback by increasing the number of tiers and discount rates in order for the model to be beneficial for all participants. She added that a cap will also be added to the model in order to ensure that entities that trade orders that are large in size also receive a benefit. In addition, the pricing for Enhanced Order functionality, the BT as well as the OP trade have also been reviewed and will be subject to a R 3000 cap. However the models as well as the pricing for the aforementioned trade types are still being discussed internally with the JSE executive committee. The final tiered model and pricing changes will be communicated to the market 3 months in advance in order to ensure that trading members are able to make technology changes accordingly.

A committee member made a comment that the tiered model should go-live prior to ITAC go-live date. Another member made a comment that the billing changes are constructive and that the JSE should see increased activity on the mentioned trading functionality such as the XT trade. The member however highlighted a concern that a tiered model will result in liquidity being concentrated in the bigger firms and added that the model disincentives firms from placing liquidity in other exchanges. DN informed the committee member that the JSE is aware of possible member consolidation, however, that is the reason why the JSE has added more tiers to the model to ensure that members, whether large or small benefit from the model. She also added that if the model results in unintended and harmful consequences then the JSE will review the model.

7. INTRODUCTION TO CIRCUIT BREAKERS IN SEGMENT ZA06

The JSE recently conducted a workshop on introducing circuit breakers in ZA06 where it was proposed to add circuit breakers as per below:

- Dynamic circuit breakers at 5%
- And static circuit breakers 15%

These circuit breakers would follow current market practices, where once the circuits are breached the market would go into a volatility auction for that instrument. It was suggested to run this as a pilot project for a three month period.

A committee member noted that the 15% might be narrow especially on illiquid instruments. Another suggestion was made to amend the circuit breakers on warrants.

8. CLOSING PRICE METHODOLOGY IN ZA04 AND ZA06

AH informed the committee that a workshop was recently held to discuss the closing price methodology of ZA06 and ZA04 and to also discuss possible solutions to resolve some of the closing price issues experienced, ie zero prices. Below is the current closing price method and the proposed method for ZA06 the workshop.

Current Method

1. Closing Auction
2. Mid BBO
3. Last AT/UT
4. BB or BO
5. Zero Price

Proposed Method

1. Closing Auction
2. Mid BBO
3. Last AT/UT
4. Previous Close

There have been instances where the closing price has been zero as a result of market makers not putting up any bids and offers throughout the day. It is a listing requirement for a market maker to be present for each ETF although there is no clear instruction for a market maker to be present at all times. A suggestion was therefore made to firm up the requirements for market makers to be present as the closing price methods are dependent on their presence on-book.

A consideration for the introduction of indicative NAV (iNAV) for ETFs was discussed, but will have to be investigated and will mostly likely only be implemented post ITAC, in the interim circuit breakers for ZA06 can be introduced.

There are investigations underway of using an iNAV and to see if both the iNAV and closing price are to be published simultaneously. There was a concern of using just the NAV as a closing price as the market would be dependent on the issuers providing prices, therefore removing independence from the closing price.

It was suggested that the JSE investigate using the closing price methodologies of segments ZA01 and ZA02 as a substitute for ZA06's current methodology.

9. UPDATE: OPERATIONAL ISSUES

TA informed the committee that post the operational issues experienced last year; the JSE conducted a root cause analysis. The issues were due to a system bug as well as people and process shortcomings. The JSE has since fixed the system defects in order to ensure that the errors do not occur again. In addition, the JSE has initiated a programme that is aimed at enhancing the JSE's operational processes. The team that has been tasked to lead this programme has been mandated to firstly, review the JSE's current operational processes and implement streamlined, automated processes. Secondly, the team has also been tasked with enhancing the JSE's current operational processes to cater for exception and disaster scenarios. Lastly, the JSE's

operational team is being properly trained on these new and revised processes, thus ensuring that the knowledge is institutionalized. TA then informed the committee that the JSE has also initiated a second project in conjunction with Business Continuity South Africa. The project is aimed at assisting the JSE in ensuring business resilience as well as to assist in defining some of the JSE's disaster management planning. TA informed the committee that the aforementioned initiatives are still underway and should be concluded in Q2, however, ITAC will also address some of the operational issues. He concluded by letting the committee know that all valid interest claims for the Equity Market have been addressed and will be paid out in the next coming weeks. Claims in the Bonds Market are currently being addressed by STRATE.

10. GENERAL

A committee member raised a concern about no notification being issued by the JSE to inform members of a Strate Fee increase which was effective from the 1st of January 2018. This resulted in a number of members not having their systems updated to cater for this change. Strate advised clients that the JSE should have notified clients. DN mentioned that the JSE will ensure that this issue will not happen again going forward. The JSE has put a process in place to ensure that Strate fee additions be included in the JSE's price list communication and sincerely apologized for any issues caused.

The committee member also raised an issue with the end of February PSTATS report that calculated STT. This report reflected incorrect amounts on what members should pay SARS and resulted in some members overpaying SARS. Upon contacting the JSE's customer support centre team; they were advised that the reports were rerun to reflect the correct values however no communication was sent. The committee member advised that some members should go back to look at this report.

The member also advised that FIC legislation has changed from an Institutional / professional client broker relationship which is very difficult to implement. They are planning a workshop with ASISA on how best to respond.

Another committee member mentioned that there is quite a lot happening on the regulatory front and wanted to know what the JSE would be doing on the new regulation for clearing. There are few things; there is a requirement for independence which needs to be done by 2020. The JSE is embarking for a licence for end of this year or early next year. The JSE has been engaging on what independence means i.e. what shared services could be shared between the JSE as well. The JSE's clearing team will be consulting with the market to see when would be the optimal time to ensure minimal market impact. There have been some consultations on whether there is any merit to moving cash equities to a CCP model and the JSE will continue engagements. The JSE's Head of Public Policy, Anne Clayton will be asked to attend the next meeting.

DN thanked everyone for their commitment and for attending the meeting.

Meeting closed at 12 pm