

MINUTES

Heading: Bonds and Interest Rates Derivatives Advisory Committee Meeting
Date: 17 February 2016
Time: 09h00 – 10h30
Venue: Johannesburg Stock Exchange - Serengeti Conference Room

Attendees:

Warren Geers	JSE (Chairperson)
Andrey Chechin	ABSA Capital (Conf. Call)
Jeshma Mowjee	ABSA Capital
Yeshveer Koobair	ABSA Capital
Gill Raine	ASISA
Adriana Weilbach	Credit Suisse
Francois Venter	Eskom
Paul Wilson	ICAP Securities
Graham H. Smale	JSE
Donna Oosthuysen	JSE
Paul Du Preez	JSE
Terence Saayman	JSE
Natasha Sigodi	JSE
Andrea Maisel	JSE
Alex Comninos	JSE
Bronwyn Bower	JSE
Bernard Claasens	JSE
Brett Kotze	JSE
Evelyn Deiner	Nedbank
Mark Southworth	Nedbank (Conf. Call)
Dean Croeser	Nedbank
Emil Kaltenbrunn	RMB
Stephen Charles	RMB
Ashley Dickinson	SASFIN (Conf. Call)
Stuart Leslie	Standard Bank
Ian Mackinnon	Tullett Prebon

Apologies: Garth Klintworth (Absa), Wayne Jackson (ICAP), Flynn Robertson (Investec), Alison Mcphee (Investec), Terry Eichhoff (JSE), Gavin Betty (Peregrine), Henry Collins (RMB), Ryan Proudfoot (RMB), Callie Hugo (SARB), Garith Botha (Standard Bank), Tom Anderson (Standard Bank), Henk Viljoen (Stanlib), Robin Mulder (Stanlib), Nick Fitzgeorge (Tradition), Perry Rungas (SGSS)

No	Items	Action Item
1.	<p><u>WELCOME</u></p> <ul style="list-style-type: none"> Mr. Geers welcomed all members present in the meeting and those on conference call and thanked them for their attendance 	
2.	<p><u>APPROVAL OF PREVIOUS MINUTES</u></p> <ul style="list-style-type: none"> The minutes of the previous advisory committee meeting were approved and there were no open action items 	
3.	<p><u>PROPOSED NEW MEMBERS AND RESIGNATIONS</u></p> <ul style="list-style-type: none"> Mr Geers announced and welcomed two new trading members. Kaon Capital has joined the Interest Rate Derivatives market and Standard Chartered Bank the Bond market. There were no resignations to announce. 	
4.	<p><u>BONDS AND INTEREST RATES DERIVATIVES (IRD) STATISTICS – 2015 Review</u></p> <p><u>Secondary Bond Market Update</u></p> <ul style="list-style-type: none"> Mr. Claassens presented an overview of the Secondary Bond market statistics for the year 2015. He stated that 2015 was a good year in the secondary bond market, adding that the overall volumes grew 21% with the Spot Bonds growing by 22.92% and Repos 25% January 2016 was a record month for bonds since the inception of the listed bond market. Ms. Oosthuysen engaged the committee by asking what their views are on the volatility witnessed in the market late last year; whether they perceive these trade volumes as an anomaly or as a new paradigm shift in terms of level of trade activity. Ms. Raine (ASISA) commented specifically on the Repo levels stating that globally the levels are declining yet the figures presented demonstrate otherwise to which Mr. Claassens informed the committee that historically repos have accounted for two-thirds of trade volumes. The trend has been observed for about three years and is attributed to the Fast Money accounts that are frequently used by hedge funds as part of their obligation to transact through their prime brokers. He added that the high repo volumes are also as a result of the market volatility witnessed last year. 	

Interest Rate Derivatives update

- Ms. Bower provided the committee with a 2015 review of the Interest Rate Derivatives (IRD) market.

Contracts traded	Bond Futures	JIBAR Futures	Bond Options	Index Futures	Total
2014	4 657 055	147 105	197 474	26 709	5 028 376
2015	5 292 686	29 850	348 297	21 924	5 692 757
Growth	14%	-80%	76%	-18%	13%

- Bond Futures account for 93% of contracts traded in the year 2015 in the IRD market.
- 1.656 million contracts been traded YTD (Jan 2016 and up to and including 15 Feb 2016). This represents a 37% increase on the same period in 2015.
- Inflation-linked Bond Futures accounted for 13.9% of total Bond Futures volume in 2015.
- Ms. Bower stated that there were now four market makers.
- Mr. Geers added that the IRD market has grown from just four instruments from inception to 27 bond futures that trade on the market to date.
- Ms. Bower advised that record open interest levels were reached at the end of 2015 with over 600 000 bond future contracts open.
- January 2016 saw a new record reached with over 700 000 bond future contracts open.

5. NEW TRADE REPORTING FIELDS FOR BONDS

Mr. Claassens took the committee through the new trade reporting fields that will be implemented from 01 April 2016.

Seven new trade flags have been introduced and they are:

- Spread Basis Point Field
 - Spread Companion Field
 - Primary Market Flag
 - Tap Issue Flag
 - Book over Flag
 - Prime Brokered Flag
 - Give Up Flag
- Mr. Southworth asked if the fields could possibly be extended to derivative hedges. Mr. Claassens informed the committee that derivative hedges could be flagged as structured deals in the trade reporting. The Structured Deals field flags all trades other than spot bond trades.

	<ul style="list-style-type: none"> • A committee member asked if there was an interest from the market to have the sector name or nature of business of the counterparty classified in trade reporting. Mr. Claassens informed the committee that currently reporting is done on the trade activity and not on the members' nature of business. • Mr. Claassens advised that there is work being done to incorporate the reporting into surveillance, he added that a directive will be introduced when the reporting fields are implemented. This will be monitored by market regulation. • Mr. Claassens mentioned that the flags are solely for JSE purposes to gather data, analyse it and demonstrate the level of liquidity that exists within the market. • This was a contentious discussion at the meeting and the committee members held opposing views on the matter. • A committee member agreed that the more data is collected and observed the better it is for the market and for transparency of the market. • It was concluded that the flags be implemented in April, the dataset will be gathered and presented to the members for a more in-depth analysis. Further discussions will be held on the impacts of the flags and trade reporting fields, but no data on the information gathered will be distributed. • The feedback will be discussed at the next advisory. 	Mr. Claassens
6.	<p><u>ELECTRONIC TRADING PLATFORM (ETP) UPDATE</u></p> <ul style="list-style-type: none"> • The MTS is the chosen service provider for the project. • The costs of the project were presented to National Treasury and the Primary Dealer (PD) forum. • The ETP deployment requires that each PD connect to the JSE system and all the information would be transmitted to Milan by the JSE. The connectivity accounts for about 30% of the entire project cost. • The exchange is investigating connectivity alternatives where the PDs can connect directly to Milan. 	
7.	<p><u>NEW PD RATES PROCESS</u></p> <ul style="list-style-type: none"> • Mr. Claassens advised the committee that there are currently two outstanding PDs who are not ready to contribute to the rates. • Currently the PD Rates process is a manual call down process however Mr. Claassens expects this to be automated by the end of February and a parallel run will take place until the go-live in March. 	Mr. Claassens

8.	<p><u>DEBT VALUATIONS RULE CHANGES</u></p> <ul style="list-style-type: none"> Mr. Claassens stated that the JSE only includes trades greater than R5 million in the MTM process. The JSE has received a request from ASISA to reduce the trade value to R1 million, this will include all bonds that fall within the illiquid valuations criteria. Mr. Claassens suggested that R1 million be implemented on all corporate bonds excluding inflation linked bonds and, the JSE will investigate the possibility of a different valuation model for the linkers. 	
9.	<p><u>CORPORATE BONDS TRADING PLATFORM</u></p> <ul style="list-style-type: none"> Mr. Claassens mentioned that the system is ready for pilot testing by the four market participants. The first phase on the system will only be for Fixed Rate Instruments. Price contributions will commence at the end of February 2016 and the platform launched to the broader market by the end of March 2016. The main purpose of the platform is to have one single venue for corporate bond liquidity and price transparency. Mr. Claassens stated that trades will be executable on the platform. Mr. Claassens will provide the committee with detailed feedback after the next work group meeting and once the platform is implemented. All members will have access to this platform. 	Mr. Claassens
10.	<p><u>PROFESSIONAL BOARD</u></p> <ul style="list-style-type: none"> The JSE has been liaising with the FSB on the suitability requirements for the Professional Board. The disclosure on a bilateral basis is in contravention with the Financial Markets Act (FMA). The act stipulates that listed securities must have information available and published to the broader market. A committee member asked how the JSE will know and identify if the client is suitable to trade in the instrument. Mr. Claassens stated that initially the JSE would restrict certain participants however that will be the duty of the FSP to perform a suitability test as stipulated under the FAIS act on their client. It will not be the responsibility of the JSE to identify suitability. A committee member expressed concern of where the liability rests in a case where the listed instrument does not meet the suitability obligations, and what the role of the regulator is in that scenario. Mr. Claassens stated that this issue and similar issues are being 	

	discussed with the FSB and the workgroup.	
11. LISTED PROJECT BONDS	<ul style="list-style-type: none"> Mr. Claassens stated that a framework for listed project bonds has been drafted and was presented to the workgroup for feedback and input. The framework is being revisited to incorporate the feedback from the National Treasury and World Bank and once the document has been finalized it will be presented to the workgroup. Ms. Oosthuysen added that the purpose of the listed project bonds is to facilitate the issuance of debt instruments and work with the FSB to reach a point where listed project bonds are classified as instruments with their own limits. 	
12. SWAP FUTURE UPDATE	<ul style="list-style-type: none"> Ms. Bower advised the committee that there are two banks that are ready to price to participants namely; RMB and Standard Bank however RMB can only make prices to all non-RMB cleared clients. Ms. Bower mentioned that three clearing banks are ready to clear to market participants which are Absa Clearing, Nedbank Clearing and Standard Bank Clearing. The JSE has had discussions with the SARB with regards to the potential that Exchange Traded Swap Futures will have no beneficial CVA treatment over OTC traded Swaps. They will be in contact with the Clearing Banks to discuss in more detail. 	
13. BOND INDEX FUTURES – CASH vs PHYSICAL SETTLEMENT	<ul style="list-style-type: none"> Ms. Bower stated that there has been a request from the market makers to change the settlement type on Bond Index Futures from cash settlement to physical settlement. Ms. Bower mentioned that the exchange can facilitate the physical settlement from a system perspective, however from a close-out perspective the physical deliveries resulting from Bond Index Futures will not offset against the Bond Future Deliveries. Ms. Raine advised that she would discuss this with ASISA committee members and provide feedback. 	Ms. Raine
14. ITAC UPDATE	<ul style="list-style-type: none"> Project 2: Commodity Derivatives Market, Interest Rate Derivatives and Bond Market Mrs. Maisel stated that no decisions have been made with regards to timelines for when Project 2 will be set off. Planning will start Q4 2016 	

15.	<p><u>PRICE BAND LIMITS ON IRD</u></p> <ul style="list-style-type: none"> • Mrs. Maisel stated that currently the asset value of the nominal bond futures is at a level of 1.5, works out to a percentage of about 16.9% (using the MTM from 16 Feb) • Mrs. Maisel stated that there needs to be an agreement on what the percent price band should be for the nominal and the inflation linked bond futures. • Ms. Bower highlighted that the limit was moved up to 1.5 late last year due to market volatility from 0.75 on the nominal bond futures. • Mr. Geers stated that the Ms. Bower should engage with the Inflation Linked market makers in bond futures to agree on a limit and get their views on whether to leave it as absolute number or change it to a percentage. 	Ms. Bower
16.	<p><u>TAKING A TURN/COMMISSIONS – GIVE UP TRADES</u></p> <ul style="list-style-type: none"> • Mr. Comminos reported that the exchange is continuing to investigate solution options to assist the market in the processing of commissions for agency trades • Mr. Comminos stated that after initially expressing reservations to the proposal to facilitate commissions via JSE Clear daily processes, the clearing members are now largely on board with the process • The initial solution that was looked at involved integration with the deal management module of the new clearing system to be delivered in ITaC. Other potential solutions include an alternative solution in the new clearing system and the FIA technology platform which is widely used by the broker community abroad. • Mr. Kotze added that role of the exchange is to act as a payment clearinghouse, the accounting and VAT payable to SARS will rest on the participants – there will be no accounting from the JSE perspective. • The trading members will have to build-in validation systems on their side to ensure accuracy. • As soon as the investigations are completed the exchange will engage further with the market on this matter. 	Mr. Comminos
17.	<p><u>STRATE DIS PROJECT UPDATE</u></p> <ul style="list-style-type: none"> • Mr. Kotze stated that Strate will be replacing its bond market system, UNEXcor and deploying a system solution from the TCS BaNCS product suite. • The JSE will be integrating into the new Strate solution; the impact will not be great as the member trade matching will continue to be done on Nutron. • Mr. Kotze mentioned that testing is expected to take place between the months of August 	

	<p>and September – dates will be communicated. The members will be involved at a later stage once the JSE understands the user acceptance testing requirements.</p> <ul style="list-style-type: none"> • The JSE and Strate will be setting up time in March with members who are retail clients to understand the impact of the system. For non-retail clients the system implication will be seamless with no major impact on their dealings. 	
<p>18. <u>UPDATE ON NON-CASH COLLATERAL</u></p>	<ul style="list-style-type: none"> • Mr. Du Preez explained the initial margin add-ons and how this will be implemented going forward. • The JSE will implement a framework whereby the JSE will stress-test each account every day; observe the P&L under the stress-test scenario; compare it to the initial margin, and when the difference exceeds a threshold of R250 million (half the size of the default fund), the excess will be applied as an additional initial margin. The worst case stress scenario for the interest rate derivatives market is currently a curve shift of roughly 150 bps, mainly driven by the events observed in December 2015. • In the IRC market there is currently no account that is impacted by add-on margins. • On the issue of non-cash collateral, Mr. Du Preez mentioned that the delay in implementation of the add-on framework was due to participants believing it is not fair to implement such a framework without an opportunity being given to them to pledge non-cash collateral against the exposure. • The rule changes to allow for non-cash collateral have been drafted, and the legalities surrounding the implementation examined. The rules will be circulated for public consultation. • The eligible criteria will potentially be a subset of the GOVI index constituency. • This will apply to an account that has been called for add-on margin and is a temporary solution to provide some relief to the participants. • A Strate collateral system will be used and testing of this system is underway. When testing is satisfactory, meetings will be set up with the clearing members. 	
<p>19. <u>GENERAL</u></p>	<ul style="list-style-type: none"> • Mr. Kotze mentioned that the exchange does the <i>JIBAR</i> calculations of NCD trading screen on 1, 3, 6, 9 and 12 months. ASISA has approached the JSE to try and extend the <i>JIBAR</i> calculation to 5 years. This is the requirement of the FSB in terms of the pricing of certain yields. • Mr. Kotze stated that conversation will continue with ASISA and it will be put up to the members especially the PDs to get their views. Ms. Oosthuysen stated that she has a few possible ideas to put forward. 	<p>Mr. Kotze</p>

20	CLOSE Mr. Geers thanked the committee for attending the Advisory meeting and participation. The meeting adjourned at 10H43.	
-----------	---------------------------------------------------------------------------------------------------------------------------------------	--