MINUTES

FINANCIAL DERIVATIVES ADVISORY COMMITTEE MEETING

Date: 13 November 2019
Time: 10:00-12:00
Venue: Serengeti Conference Room – 13rd Floor, JSE Offices, Sandown

Present:	Langa Manqele (LM), Kgabo Molabe (KM), Kim Hoosen (KH), Valdene Reddy (VR), Luke Alers (LA), Martin Koch (MK), Jacob Shayi (JS), Elsa de Goede, Mark Randall (MR), Mzwandile Riba (MR), Anne Clayton(AC), Mtho Mvubu, Ved Somera (VS), Pierre Badenhorst (PB), Roberto Pharo (RP), Shahil Soni (SS), Elinor Bodinger(EB), Funiwe Tokota (FT)
Apologies:	Conrad Africa (CA), Alex Comninos (AC), Wilhelm Kuys (WK), Aveshen Pillay (AP), Helen Masson (HM), Eben Maree (EM), Guy Agleo (GA)
Dialled In:	Matthew Arnott (MA), Phillip Dube (PD), Petrus Bosman (PB), Shiran Samuels(SS)
Webiner:	Jolin Majmin (JM)

1. **WELCOME AND APOLOGIES**

   (VR) welcomed everyone to the fourth quarter Financial Derivatives Advisory Committee meeting for 2019. She further made apologies for Alex Comninos and Wilhelm Kuys (risk team) who were at a conference overseas and couldn't attend

2. **CONFIRMATION OF PREVIOUS MINUTES**

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

3. **VALUATIONS UPDATE**

   (A) INDEX ATM VOLS

   (MR) advised that they issued a consultation paper and have held one on one meetings with members that provided their response on the consultation paper.

   - For single stocks, the valuations team has automated the MTM process which uses trade data to calculate ATM vols based on the skew adjustments that they apply with some validation to limit the daily change to 6% vols.

   - The reasons for this 6% daily vol change is that the sticky delta adjustment that they apply can go away from what the market sees as the implied volatility. The second reason is that we still have some challenges with the

way the market books their trade. If trades are booked at an incorrect futures price, they will yield incorrect vols therefore incorrect mtm. We have now requested that the market books their trades at the correct futures price on the day that it was traded

- There have been instances whereby stale data in a form of a stale futures price has been used to book trades, which obviously results in incorrect mtm. A change that the JSE has done to take account of the stale data is a model that has been built, that takes a combination of realised volatility and trades in related shares, and makes adjustments to other shares that may have become stale over time

- Another implementation that has been done is the change of the JSE genetic skews for all expiries to incorporate the vendor data. This is still one skew for all single stocks which is still not ideal. This skew is an improvement as it shows a better reflection of the curvature that we see in the market and the term structure of volatilities. This is applied every Tuesday by the valuations team. The long term view is to apply sector a specific skews for single stock options

- Current methodology with index ATM volatility is the use of a constant spread between ALSI vs DTOP and ALSI vs DCAP. Currently, a spread of 1.5% between DTOP and ALSI and 0.75% between DCAP and ALSI. Is being applied. This constant spread obviously doesn't apply constantly throughout the term structure. The VIS team is working to determine a separate ATM vol for DTOP, DCAP and ALSI. Anyday Contracts are linked to the next near in terms of the ATM volatility

(B) DIVIDEND ESTIMATES

(MR) advised that they have reviewed the coverage and pricing of different data vendors i.e IHS Markit, Bloomberg, Refinitiv and IRIS locally.

- A response was provided by Refinitiv especially because they already have a relationship with them.
- Commonalities were found with the methodologies used by IHS, Refinitiv and Bloomberg.
- A pricing advantage was found mainly due to their existing relationship with Refinitiv. The VIS team have started to transfer data into VIS in the format that would be required by this data vendor.
- (RP) asked how the JSE can circumvent using an incorrect Futures Price when trading on-screen options. (MR) advised that they were supposed to be receiving a futures ref for options that are traded on screen but they are not. Because of this, they therefore cannot calculate the moneyness for on screen options and therefore the ATM volatility. At the moment, they are doing a manual temporary fix. The dev team started with a fix that will allow the JSE to calculate ATM vols from the closing futures price that we have in the system. This is a long–term solution that is expected in the next three months. (RP) also asked whether it would be possible to get more points from SuperDerivatives as he often finds they're 10 points away. (MR) advised that the inability to get more points is actually a systems limitation as it assumes linear interpolations

4. INDICES UPDATE

(A) FTSE/JSE Consult on NPN/PRS Capping

- (EG) advised that there has been a concern by various market participants with regards to the high combined weight of NPN/PRX in the capped index, specifically in the capped SWIX ALSI index
- Initially the introduction of the capped indices were to reduce the concentration of NPN in the indices by capping the indices at 10%
- NPN and PRX are viewed as two separate companies so they are capped separately
- At the moment, the two companies' combined have a weight of over 12% in the capped SWIX ALSI
- To address the concerns, two workshops were held and a market consultation paper on the capping of NPN and PRX was issued on 5 Nov 19 which will close for comments on 22 Nov 19
- **First Proposal**: Treating NPN and PRX as one company/entity in the Capped SWIX indices for capping purposes only to alleviate the single large exposure risk there currently is to Tencents
- **Issue:** This might become a more pronounced problem in the future as the prices move and weights might go up
- **Agreement/Proposal**: Implement a rule that is not company specific in case this happens again in the future, i.e. implement a rule that will resolve any large single stock exposure by looking at how much the valuation of the subsidiary company contributes to the market cap of the parent company
- For the above rule to be implemented, the below need to be met:
    o Both the Subsidiary and parent company must be JSE listed
    o Parent Company shareholding in the subsidiary company is restricted for free float purposes
    o There will be consideration of the gross market cap of the holding company
- If the parent company owns more than 75% in the subsidiary, then the parent and the subsidiary will be considered as a single company for capping purposes which will only be relevant to capped indices
- If the companies fall below 65% at the next quarterly review, the two companies will be split again and capped separately
- If the proposal is implemented, the combined capping of NPN and PRX will move from the current capping level of 12% to 10%

- Some members advised that they don't think it's the right view to start fiddling with indices post corporate actions especially for members that hold derivatives instruments i.e. options that are far out. The suggestion is that we first allow the instruments with open interest to settle and then to trade into new instruments as this will impact PnL on derivatives
- Some members say it will be super destructive for their international clients.

(B) Convergence of ALSI and SWIX ALSI

- (EG) mentioned that ALSI and ALSI SWIX were currently converging
- The only difference between the two indices is a handful of grandfathered companies, but very similar as far as the constituents
- A consultation paper was issued last year and feedback received from the market was to replace the ALSI with the SWIX ALSI and have one version.
- There was also appetite from the market to introduce the New S.A investor index and Foreign upweight index., i.e. two separate indices
- New S.A investor index looks to have all the constituents, weighted upon their aggregate S.A shareholding
- The Foreign upweight index would be upweighted to the full foreign free float by using their global weight. At the moment, foreign companies are down weighted. Further market consultation will be done next year
- Markets were off the view that decreasing the number of indices is the right direction

5. **NEW PRODUCTS DISCUSSION**

VARIANCE FUTURE

MIT upgrade to the latest version 40(x), with new feature and enhancements is on JSE's priority list.

In Equity Derivatives, the enhancements will enable us to land **Variance Futures** from a Risk and a Tech perspective.

From the advisory, we need to know if we get approval on the proposal for:

- Variance future (in relation to the products the difference being the Variance Future being an exchange product)
- If the product mechanics are correct
- Can we prioritize this as a product enhancement for the second half of 2020

Variance Futures Mechanics:

- (KM) highlighted that the product was designed to hedge or speculate on the volatility of an underlying asset.

- Offers volatility trading in its purest form and replicates the payoff profile of an OTC Variance Swap.
- Will initially be listed on Top40 Index, with quarterly and annual expiries.
- Min Vega notional R100 000, Cap 2.5, Discount rate will be JIBAR and Variance point = 1
- In summary the only difference between this product and the OTC variance swap is that the exchange product will be discounted to get to some PV

6. EDM FEE REVIEW

- We did a global benchmark analysis and comparisons, which led us to the key priorities that we are proposing.
- The JSE is probably the only derivatives exchange that is on value based billing model, and at this point, there is no conversation to get this changed.
- Options price vs Futures: the options previously had delta of 40%, hence options now are still relatively cheaper by 40% than Futures, and there is no immediate call to narrow that gap.
- SSF (Standard vs Any Day), very high up in the priority agenda, there are price misalignments. The aim is to align them, and the SSF being one of the more expensive products in the JSE Equity Derivative market offerings.
- Liquidity Providers Schemes: there are various types of liquidity providers ranging from formal requirements and qualification to participate – to those who purely provide volume without any standing requirements.
- Having liquidity providers is something that we are looking into quite soon; however, we need to consider how the tech part is going to work since the exchange only interacts with the member rather than the end-client and how the benefit is going to cascade to the end client.
- Key initiatives highlighted from the EDM workshop:
    o Pricing (SSF price point changes and trade caps)
        ▪ Reducing the price point
        ▪ Introducing a lower Cap on SSF
    o Split Liquidity (Merge the DTOP and ALSI)
    o Corporate Actions
    o Valuations
    o Margin and Risk

- For an agency trade, a 50% discount is given when doing an Assign or Tripartite on all products.

- Give-Up trade type affects the clearing members who would deal assign trade through a reported trade. Now this trade type makes it easier and cheaper to select this trade type to be able to pass on (allocate the trade) to the end client of the Clearing Member.
- We are working with Market Regulation and still trying to figure out how this will work from a tech point of view.
- These are aimed as targets for 2020. We are still awaiting approval for the price changes in the pricelist.
- (RP): JSE should offer more in the price reduction and be able to be competitive with the global peers, on the current margins

7. UPDATE- ITAC PRODUCTION ISSUES

Billing

- (KP) provided an **u**pdate on two billing issues we had outstanding post go live
- First one was the roll trades which were not carrying through on the deal managed legs. Changes have been made and will be going live weekend of 16 Nov 19
- The other was exotic options discounted on the allocations. The discount wasn't being applied correctly on the exotic options legs. Amendments to this will go live on the 16 Nov 19.
- Members no longer have to submit for refunds as these will be done automatically
- There are however two issues that are still outstanding; Single Stock Options and Calendar Spreads. These will still be manual. Changes on these are expected in 2020.

8. OUTSTANDING ISSUES

(A) Margin Calculator

- (LM) highlighted that we have already received a proposal and a solution from an independent vendor
- Due to complexities of this project, the solution will be given to us in two tranches
- We will get the margin calculator first. Once that's done, the options calculator will follow
- Currently, the calculator has the following defects:
    - o Cannot calculate margins on a contract that hasn't been listed
    - o Cannot put your own expires, has to be existing expires
    - o Doesn't accurately calculate margin offsets
- We are currently building in the functionality to upload a position
- Capital Markets has given their comments to the external vendor. Awaiting comments from Risk, then we will send it to exco for approval

- N.B. The calculator will not be coming with the functionality to calculate margins on exotic options. This will be looked at, at a later stage

(B) Corporate Action: SSF Contract Size Change
- (LM) advised that the intention of the project is to change the contract size for single stock futures from 100 to 1
- The biggest challenge comes is the system, as code changes will need to be made on the clearing system (RTC), valuations system (VIS) and reference data system (MDS).
- We need to identify core resources for the project
- Only thing that's pending is exco approval

9. DISCUSSION

Extension of Trading Hours

(VR) advised that there are three things to be discussed:

(A) Extended trading hours of our TOP 40 futures or the Dollar Rand Futures
- The S&P 500 trades 24/7 and other exchanges have proxy indices that trade throughout the night.
- Singapore for example has about 15 end off day session. It doesn't mean that you need to extend your hours. The trading hours can still remain as they are today but we will have new sessions that trade throughout the night. Back office support staff, clearing and settlement will then book the trades the following morning.
- Eurex got better stats from extending trading hours. (RP) advised that the liquidity in the EDM market tends to die down after the equities market has closed so he doesn't think that extending our trading hours to tap into U.S market will assist in increasing liquidity.
- He further advised that the opportunity will probably be more for the Asian markets. One of the members advised that he thinks that because other exchanges are going this route, it might be beneficial for the JSE to extend their trading hours. The JSE still has a lot to explore on this but what we wanted to test is whether or not this is the route to go?

(B) Listing our contract i.e. TOP40 on other exchanges e.g. Eurex Exchange
- There are downsides and upsides.
- What we'd like to explore is whether we want our product to compete on other exchanges?
- Whether we want to make it a more relevant product in the U.S through marketing?
- Since FTSE bought Russel, they've been saying that they would want to trade our contract on CME but we have been reluctant to do so.

- (RP) advised that he thinks it's dangerous to give our contract to another exchange.
- Majority of members agreed with (RP) sentiment, that it would be a bad idea to have TOP40 on Eurex

(C) Activity of MSCI S.A on Eurex Exchange

- MSCI S.A actively trades on Eurex with 20 thousand open interest.
- ICE has the same contract with no activity and no value traded.
- The same product (MSCI S.A) is available in S.A but there isn't activity on it. Question is, how do we create liquidity in this product locally?
- Members advised that they will push the product if they got margin offsets between this product and the TOP40.
- (LA) advised that MSCI S.A is trading cheaper on Eurex in comparison to the JSE and that if the JSE would make the product cheaper, provide margin offsets, get market makers on the product and acquire CFTC approved, then activity is bound to move to the JSE.

10. MARKET CONFIGURATION

Circuit Breakers

- **(KP)** mentioned that there have been concerns around DCAP circuit breakers
- ALSI has no issue. Issue seems to be with DCAP and DTOP
- The issue with DCAP arises because it is mostly traded off screen. The moment there is an on screen trade, a volatility auctions gets triggered
- When the 2min volatility auction is triggered, underlying market moves significantly resulting in no match
- The suggested solution was to separate circuit breakers for ALSI vs DTOP and DCAP or to do away completely with DCAP and DTOP threshold. Dynamic =1% and Static = 5% for Index Futures
- Another suggestion was to have a different circuit breaker particularly for the first trading day. This solution would however be long term
- Committee landed on widening the circuit breakers

11. REGULATIONS UPDATE

- **(AC)** advised that the IOSCO consultation on the requirement to synchronise clocks to universal time across all trading systems was due to go live on 13 Nov 19. This is to eliminate market manipulation that can occur from timing mismatch across the trading systems in different venues.
- There was a large amount of work done on regulations in 2017 and 2018 around COFI bill, and Short Selling. However, there is a huge amount of regulations and legislation stuck in draft with the National Treasury as they are currently focused on the state of the economy

- One thing that is on the National Treasury's priority list is a bill for the resolution of banks which will hopefully be gotten into parliament beginning of December.
- We expect to see COFI again into beginning of 2020. The rest of the legislation and regulation we have no time line on

12. GENERAL

- **(VR)** highlighted the importance of having a healthy mix of market players in the committee.
- On the buy side, we have Eben Maree from ABSA.
- A proposal was made for Adrian Jeffreys from Sanlam to join from a sell side perspective.
- Willie Koorts from Citigroup also requested to join.
- FDAC members to provide their thoughts on the abovementioned proposals via email