JSE

MINUTES

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FINANCIAL DERIVATIVES ADVISORY COMMITTEE MEETING

Date:	23 October 2018
Time:	10h00
Venue:	Ubuntu Conference Room – 1st Floor, JSE Offices, Sandown

Present:	Donna Nemer (DN), Guy Algeo (GA), Matthew Arnott (MA), Ved Somera (VS), Langa Manqele (LM), Godfrey Matjuda (GM), Kim Hoosen (KH), Valdene Reddy (VR), Chris Grove (CG), Terence Saayman (TS)
Apologies:	Brendan Harcourt-Wood (BHW), Eben Mare (EB) , Leanne Parsons, Phillip Dube (PD), Shiran Samuels (SS), Petrus Bosman (PB), Bryan MacCallum (BM), Bryan Hatty (BH),
Dialled In:	Naval Singh (NS), Aveshen Pillay (AP), Roberto Pharo (RP), Crispin Gell (CG)

1. WELCOME AND APOLOGIES

DN welcomed all the attendees to the fourth quarter Financial Derivatives Advisory Committee (FDAC) meeting for 2018.

2. CONFIRMATION OF PREVIOUS MINUTES

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

3. 20 MINUTES OPTION ABANDON PERIOD ON FCO

At a previous advisory meeting, members requested the JSE to review the time period provided for the Exercise and Abandon of options on Futures Closeout and possibly look to have the end time fixed. The auction process used to determine Equity Derivatives close out prices takes 15 minutes but could be extended due to market order extensions or price monitoring extensions. In addition to this, after the uncrossing, there is an index price calculation and an overall internal verification of FCO prices' process that takes place before prices are published to the market. Due to this variation in the time, the proposal going forward is to stick to the 20 minute period being a fixed period that will commence from the time that the FCO prices are published.

A concern was raised that this was a long window during which the market is exposed to sort out their risk for the option positions held. A member asked if there is a way to standardise the time in which the FCO prices are published as this has varied on previous FCOs. The team advised that the proposed SLA for the publishing of FCO prices is 20 minutes. Members are of the opinion that the 20 minute SLA is quite long – the team advised that they would take this concern to the relevant teams to review and advise.

4. ITAC PRODUCT CHANGES

Market Order Functionality

After consultation with the market, regarding the enablement of market order functionality for the Equity Derivatives market for ITAC go live, the JSE team has received views both for and against. Committee members raised strong concerns about having the functionality enabled as this is new to the market and fat finger errors could have a negative impact to the market and this introduces risk and complexity to the market.

Other market participants have expressed a requirement for this functionality as it is a value add, and provides access to the market for this and other order types such as Stop orders, Market to Limit order and Market if Touched orders. The proposal from the JSE is to enable the functionality for go live, however, issue a warning to the market to be aware of these order types and also monitor it very closely for a period post go live. If members wish to have the functionality disabled from their trading frontends, they can discuss the removal of this functionality with their software vendors.
Circuit breakers will also be in effect, and although the current parameters set, may not prevent fat finger issues, it was agreed that the JSE would tighten the thresholds for go live as a means to mitigate possible errors. The JSE team will also be circulating definitions on the new order types and how each of them work. Training sessions can be conducted if required by clients on the new functionality.

Strike interval change on Any Day Index Options

The committee was reminded about the change to align the strike interval of AnyDay Index options to the relevant standard index option instruments. This will affect the ALSX, DTOX and DCAX instruments that will align to ALSI, DTOP and DCAP respectively.
This means a change to the contract specifications of each instrument. A formal notice of the change to contract specifications will be issued to provide 30 days' notice to the market. The JSE team will also be engaging with each position holder to discuss the impact to their positions and the migration of current positions. Migration of the positions in the current strike interval to the new, rounded strike interval will be done by the JSE.

5. MARGINING ON ILLIQUID SINGLE STOCK FUTURES

All derivative instruments listed on JSE need to meet the minimum listing criteria. Due to market events some of the instrument's liquidity can drop to below the prescribed listing levels. In such cases the JSE will look to increase the margin on the instruments so as to protect the clearing houses and clearing members in case of an unwinding of position due to participant default. This forms the basis of the increase in margins on some stocks which is to be done over a period of a month.

There were no changes to the listing requirement introduced in the document circulated.

A comment was made that the JSE is not in a position to offer the same product with Single Stock Futures as international banks on the OTC market. The product is superior in its simplicity of use.

Another point was raised about Total return swaps between banks and that it would be easier to trade these on exchange. The stumbling block on this product for the brokers would be fees, if not capped. These trades would be generally large in size and would attract large fees. The JSE is currently reviewing its pricing and looking at the pricing of all products.

6. CORPORATE ACTION DISCUSSION

Problem Statement – current treatment	FDAC Recommendation – future treatment
Rounding Up/Down The Position Adjustment Factor used determine a ratio by which to allocate additional positons and its subsequent rounding up or down often result to:- • A potential arbitrage of Maker Makers by clients. • Clients not qualifying for additional new positions after a rounding has been applied.	Investigate the impact/feasibility of reducing contract size from **100** to **1** on systems/processes. Investigate feasibility of ***"Passing a Cash Journal"*** in lieu of adjusting positions. **Note:** Clients should advise the JSE how they would like the corporate action to be applied to the Structured Products.
Baskets • Clients often want to trade individual futures contracts but are unable to do so. • Clients could incur booking fees when trading out of a basket, and into the individual contracts. • In extreme cases, Margin Off-set benefits could be lost. • Baskets cannot be created on International Equities.	Enable trading into individual SSFs positions Post ITaC go-live. Apply a Zero Fee when clients trade out of baskets. (This will be a temporary process, it will be phased off once trading into individual SSFs has been enabled post ITaC)
New Instrument a) A **Spin-off** resulting in a delayed listing of the new contract. e.g. 2.5 Grindrod Shipping (GHS) Limited for every 100 Grindrod (GND) Limited SJ Equity, 13 June 2018 b) A **Spin-off** resulting in a contract not eligible for listing. e.g. *1 PUMA SE* for every *12 Kerring Euronext Paris*, 14 May 2018	For scenario (a), clients will carry a flat position as at LDT, positions will be created on a new contract on its listing date. This cannot apply on positions with Options, a Basket will be required. For scenario (b), JSE will execute a ***'Forced Closeout'*** prior to expiry. A Capital Reduction isn't preferred as it requires an estimation on an unlisted contract and Baskets are not permitted on international equities.
Net vs. Gross Dividend The treatment of Dividend and/or Special Dividend paid on: a) JSE listed equity b) International Equity (IDX)	For scenario (a), the Gross Dividend and/or Special Dividend is applied on a JSE listed equity. For scenario (b), a Gross Dividend and/or Special Dividend is applied as tax treaty agreements may apply differently across jurisdictions irrespective of the underlying's listing exchange.

7. INDICES UPDATE

Index treatment on free float rules. The current free float rules pose some challenges, there are two fundamental changes made on these rules are:

- The previous rule of 5%-15% hurdle rule has been completely dropped. Now the standing rule is that the minimum hurdle requirement is now 5% of free-float for all companies.
- On Inward listed shares, the current rule is that a company must have a 1% free float, keeping in mind that the indicated 1% is on the South African register held shares and not on the prescribed total shares. A case in point is ABinbev which has a low local holding in shares however the value is Rand terms in quite significant placing it in the index Top 60. The rule now is if a foreign company does not meet the 5% minimum hurdle requirement but has a significant Rand value, the Net Rand value of the Local Holdings should be above 10% value of the Mid-Cap index (no fixed nominal figure) for it to be included into the index.
- These reviews will take effect in December 2018.
- We are looking into benchmark design as a way to include local holdings into the index. There are some inconsistences in benchmark design where the Local Companies are not viewed on resident and non-resident breakdown. However the older Inward listed companies are looked at resident and non-resident holding such as Richemont, Anglo American and Billiton but the recently listed ones are not looked at in this way. A light consultation was done in the market and we intending to put out a consultation paper in November on this issue.

8. MTM VALUATION METHODOLODY DTOP & DCAP

A highlight on changes made this year on the ALSI/JSE methodology in pricing the far-contracts where the price gets stale we use a MTM methodology, if there a no bid/ offer on screen then we change the price. We have brought in a vendor skew using Super Derivatives for the Alsi Skew. If the far- dated contracts' volatility is stale we use the vendor volatility number to update the far falls.

On the DTOP and DCAP valuations, we use the underlying spot value and use our own JSE dividend projections however there are some challenges on it. The proposals from market members is that;

- The JSE should put the DTOP and DCAP to an on-screen pricing process. There was a counter proposal to this in moving the Alsi to a Mark-to-Model process and tidying up the dividends projections.
- The other suggestion is on the timing of the market snap shot, that it should be run earlier at 16:59 a minute earlier.
- The last suggestion made was for the exchange to get the volatilities and not just the curves from the vendor.

The intention is to put this on a consultations paper in a few weeks that will go out to the market to comment in a more structured way.

The JSE no longer uses a polling system but rather sources information from a vendor Super Derivatives which does use polling to gather its data.

9. OD UPDATE

Trades that meet the criteria set out below will be charged a Zero Fee:

- The OD needs to be reported within 30 days of the original trade
- The original trade needs to have been on the JSE
- The derivative referenced must be reported to the JSE

All OD trades that are not linked to a duplicate AT trade within the period, will attract a fee.

- Given these trades are negotiated trades, they will fall under our complex suite for large-in-size and/or dark and will be priced at 0.53bps with a R3000 cap.

Proposal

Clients to create a new BDA account:

- All AT's related to OD's should be allocated to this account
- All OD's should be booked out from this account

The JSE will reconcile the activity in this account on a monthly basis and zero fee the OD's with related AT's This should be within the same BDA period.

Note:

For OD's sent that have a zero-fee, the recipient leg will also be zero-fee'd.

The JSE is working on the files and flags that would be in use to identify OD's that would be zero rated. Once the process has been concluded a market notice will be sent out detailing the changes and requirements.

Client feedback

The JSE has been focusing on what should be charged as clients have mentioned that most of their activity should be zero rated.

There are differences in practice of how members transact using the OD trade type, some members spilt out their OD business from all other business and some use the same accounts. When the OD trades are separated it is easier to flag the accounts versus when all activity is in one account. There are some brokers that have mentioned they are not in a position to change their processes as it has downstream billing implications.

Majority of the brokers have mentioned that they would be happy to flag the accounts and not fundamentally opposed to the idea.

Client have also requested that they would prefer the credit for the OD's to be in the same month from an admin perspective.

10. ITAC UPDATE

A market steering meeting was held where it was discovered that there are still some outstanding issues from the clearing side. There is a code drop scheduled for the 26th of October which will be to remedy the outstanding issues. With the successful testing of the code drop a February go live might be feasible. The steering committee will meet again on the 5th of November to assess the impact of the code drop.

One of the clearing members have mentioned that if the go live is not in November, they would not be in a position to go live before April 2019.

11. GENERAL

A request was received for Luke Alers to become an FDAC member. The nomination was accepted by all members and an invite will be sent out to Luke for the next advisory sitting.

Meeting ended