

MINUTES

FINANCIAL DERIVATIVES ADVISORY COMMITTEE MEETING

Date: 08 November 2017
Time: 10h00
Venue: Ubuntu Conference Room – 1st Floor, JSE Offices, Sandown

Present: Donna Nemer (DN), Alicia Greenwood (AG); Guy Algeo (GA), Crispin Gell, Leanne Parsons (LP), Mark Randall (MR), Valdene Reddy (VR), Phillip Dube (PD), Matthew Arnott (MA), Ved Somera (VS), Langa Manqele (LM), Zweli Vonya (ZV), Sibusiso Maseko (SM); Tshwantsho Matsena (TJ)

Apologies: Godfrey Matjuda (GM), Andre Koen (AK), Helen Masson (HM), Bryan MacCallum (BM);
Jacob Shayi (JS)

Dialled In: Gavin Betty (GB), Shiran Samuels (SS), Petrus Bosman (PB), Naval Singh (NS), Richard Juchniewicz (RJ)

1. WELCOME AND APOLOGIES

DN welcomed all the attendees to the third Financial Derivatives Advisory Committee (FDAC) meeting for 2017.

2. CONFIRMATION OF PREVIOUS MINUTES

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

3. MATTERS ARISING

3.1. COLOCATION CONNECTIVITY INCIDENTS

The committee was informed about the colocation network disconnection issues experienced on 7th November 2017. It was mentioned that the JSE's systems vendor initially struggled to identify the anomaly that was causing incident and due to the impact to the market, a decision to halt the market and to restart the firewalls. Subsequently, the JSE in collaboration with the system vendor manage to identify the root cause to be a software bug in the current firewall software. Numerous health checks and corrective actions were taken immediately to ensure the anomaly does not happen again along with replacing the colocation firewalls with different technology was applied the following weekend.

A committee member asked whether the JSE picked-up the problem by themselves or where they being informed by the markets. TJ admitted that some market participants made calls to the JSE informing them about the issue and also the internal team were seeing anomalies on their own checks. At times it is a very challenging exercise for the JSE to

actually pin point the problem and diagnose whilst the problem is occurring. Since then, the JSE has tested all stations with the new firewalls for the forthcoming dress rehearsal. Members are encouraged to participate in the upcoming dress rehearsal and to assist in volume testing as part of the dress rehearsal. A committee member asked on whether corporate actions should be tested on dress rehearsal and was advised that the corporate actions will be part of clearing members test plan and will not be tested on Saturday's dress rehearsal.

3.2. ISSUES REGARDING SETTLEMENTS AND CORPORATE ACTIONS

AG informed the committee that the JSE will be hosting a broader market feedback session where STRATE and the CSDPs will be present in order to discuss the settlement issues experienced since 20th September starting with Naspers corporate action. She added that the JSE is aware of some of the causes of the issues but has also decided to conduct an independent review. The independent review will assist the JSE in implementing the most appropriate corrective action and will be conducted by Deloitte. AG firstly detailed the issue in processing a large corporate action a day before futures close-out (FCO). The processing of corporate actions is currently a manual process and this process has worked well in the past. This time however, the team underestimated the amount of work required to process a corporate action of such a large counter and were not able to do so in time. AG highlighted that the JSE will automate this process with the implementation of ITAC and in addition, the JSE has implemented additional processes to ensure more robust planning for these events. She then informed the committee of the Equity issues where the JSE's trading system did not have FCO in its calendar. The JSE decided not to run FCO manually as it has never done so before in a production environment and that might have resulted in unintended consequences. After much consultation, the JSE decided to start the market later and this proved to be the most prudent approach.

AG then informed the committee of the marked-to-market valuations issue experienced on a basket related to the corporate action counter. The pricing and valuation of instruments take place in multiple systems and this involves a manual process of consolidating all information. These are also systems that will be replaced by fully automated systems in the ITAC world. However, what essentially caused the issue was a decimal error which caused the price of the basket to be incorrect as well as the margin. The issue was resolved in the overnight run that night.

AG concluded by informing the committee of the JSE's clearing system not picking up the Public Holiday on the 25 September. Therefore trades that were booked on the 20th and 21st were processed for the 25th instead of the 26th. What complicated the matter for the JSE is that, in its Equity's clearing system, the code has been partitioned and the issue only affected one part of the system's code. This therefore masked the issue as only a few trades were affected and the JSE was only able to recognize the calendar issue on the Friday morning. Therefore, when the calendar issue was identified and fixed, all subsequent trades had no issues. The JSE however had to now reverse trades for the Wednesday and Thursdays that had rolled and netted overnight erroneously. The JSE corrected the erroneous trades over the weekend up until the Tuesday. However, due to the fact that DIS was also being implemented that weekend, the situation got exacerbated as some of the corrective action that was taken, could not be implemented due to systems not being available. On the Tuesday, a number of settlement groups did not settle and the JSE therefore had to roll settlement for the Friday. There were approximately 5000 failed settlement orders which is a high number that the JSE does not usually have to contend with. During that period, a number of decisions had to be taken such as closing out BDA on certain days so that the JSE could see what the positions were and do stock lending to balance off some of the settlement orders. As a result, the JSE ended up with some reconciliation issues; however all reconciliation issues have now been resolved. She then requested that any member who still has issues should let the

JSE know so they can be assisted. In addition, members who have interest claims should send them to the JSE on the following email address: SettlementAuthority@jse.co.za for review.

There are a number of improvements that the JSE has implemented to ensure that the abovementioned issues do not take place again and the JSE will also be implementing other additional controls and checks.

DN went on to apologize for the inconvenienced caused by the issues and thanked market participants for their support and comradery in resolving the issues.

A committee member then asked if the JSE will be sharing the results of the independent review with the market. DN mentioned that the JSE will share high level feedback to the market.

A question was then raised as to whether the JSE can stop corporate actions from taking place on the week of a close-out. DN explained that the matter has been discussed at length internally and the agreement has been that to the extent that the JSE can, it will give guidance to issuers however not something we can formally prescribe. DN highlighted that as the JSE moves to monthly expiries it will be a bit tricky to do so. The JSE will in addition try to align itself to international norms and ensure that its processes are automated in order to handle such large corporate actions without causing disruptions.

4. ITAC PROJECT UPDATE

The JSE's preparations for ITAC are going according to plan; ITAC will be changing all derivatives technological processes as they currently stand. There have been 2 internal dress rehearsals conducted as well as 2 software provider dress rehearsals. The next dress rehearsals will be mandatory market dress rehearsal scheduled for Saturday 11th and 25th of November. These rehearsals are mandated for all Clearing members, trading members and real-time information subscribers. All connections and trader ID connections need to be tested on the day.

All queries and questioned can be directed to itac@jse.co.za, The JSE has sent out a presentation providing all the information on the dress rehearsal. Each trading and clearing member firm will be assigned a buddy for escalation of issues leading up to the day and on the day. Clients can further escalate any issues to leannesp@jse.co.za if their issues have not been resolved.

Connectivity tests with software providers have been completed with 95% of client enablement's also concluded. Some of the clients will be testing with multiple vendors on the 11th but for the testing on the 25th clients need to test with the providers they will be singing with.

Mandatory clearing member testing will commence on the 13th of November and JSE will be exploring ways to expand the mandatory clearing members testing in 2018 to include trading members.

Targeted go live date for ITAC is the 19th of February with a contingent date of 26 March 2018.

4.1. SINGLE INTEREST RATE ON MARGIN HAIRCUT AT A PORTFOLIO LEVEL

AG reminded the committee about the discussion held regarding the JSE's vision to enhance its risk management practices by calculating margin at a portfolio level, rather than at individual contract levels. The Risk and Clearing system being delivered with the ITaC programme has been designed to cater for this. As such, once markets migrate onto the ITaC platforms, portfolios will be netted to the extent possible and margin charge at the portfolio level. This means that a single margin calculation will be performed and a single margin haircut rate charged. Currently,

different rates are charged for Equity and Commodities derivatives (20 bps) than for currencies and interest rate derivatives (12.5bps). The JSE has done significant work to find a single rate that will minimise the impact on the market, and are proposing a rate of 17 bps. When analysing historical portfolio make-up for trading members, the rate of 17 bps is found to be beneficial to the vast majority, with only a small proportion (less than 5%) experiencing cost increases. Moving to a rate of 17 bps will result in a negative revenue impact for the JSE. The JSE proposes moving equity, commodity and currency derivatives to the 17 bps rate at the same time that ITaC goes live (anticipated Q1 2018), but to keep interest rate derivatives at 12.5 bps until such time that this market migrates to the ITaC platform in late 2018 / 2019. The JSE is open to market/member comments and queries relating to their portfolio impact analysis on a one-on-one consultation basis.

5. WMCO FX FIXING RATE

VR presented the proposal from some participants to switch from Reuters' ZAR=D3 to Reuters WMCO fixing rate used to convert underlying securities denominated in foreign currency for settlement at expiry date. This impacts IDX and Can-Dos in EDM.

The FDAC committee agreed to switch to Reuters WMCO and requested the JSE to:

- a) Carry out an analysis of the Basis Risk/Spread differential between Reuters' ZAR=D3 and Reuters WMCO fixing rate.
- b) Carry out an internal impact assessment on systems, processes and licensing implications and;
- c) Check with price makers for general comfort.

6. VALUATION UPDATE

MR reminded the committee about the discussion held in the previous meeting regarding ALSI MTM changes that were implemented and the skew replacement as provided by the vendor Super-Derivatives on a weekly basis. In addition, valuations team has been updating the ATM volatility for all index contract expiries that have had stale prices using Super-Derivatives data and there have not received any complaints as a result of the change/update.

A committee member suggested that the valuation methodology for the DTOP and DCAP contracts change from the existing mark-to-model process to the same mark-to-market process used for ALSI. The FDAC approved in principle the proposal of changing the valuation process to using mark-to-market methodology on DTOP and DCAP as well, and asked the JSE to investigate implementation.

7. NEW FTSE/JSE INDICES

MR informed the committee that FTSE/JSE has launched factor indices and property index suite. The factor indices are constructed with the objective of providing exposure over time to a factor of interest and are mainly based on the FTSE/JSE All Share index. The factor indices may have liquidity concerns but Can-Do can be created on them if needed. They are built on a rules-based process which makes them transparent and replicable. With regards to property indices, the JSE has been collaborating with the index user community on index construction. Newly three set of property indices has been launched in October 2017 and these are:

- FTSE/JSE All Property Index (J803)
The FTSE/JSE All Property Index consists of all constituents of the FTSE/JSE Shareholder Weighted All Share Index which belong to the ICB Real Estate Super Sector. The constituent's weights will be capped at 15% on quarterly basis after application of corporate actions
- FTSE/JSE Tradable Property Index (J800)
The index will have a minimum of 10 constituents based on Shareholder weighted investable market capitalization. Constituent weights will be capped at 15% on a quarterly basis after the application of corporate action
- FTSE/JSE SA REIT Index (J805)
The FTSE/JSE SA REIT Index consists of FTSE/JSE All Share Index constituents designated as a South African REIT. Constituent weights will be capped at 15% on a quarterly basis after the application of corporate actions.

A committee member raised a concern on index pricing information and subsequent lack of proper distribution channels and; clear data contractual agreements. LP offered to escalate and resolve any issues and concerns relating to market data subscription team and asked the committee to bring forth any further issues that they are experiencing with the JSE market data services.

ZV asked whether any of the existing property indices will be discontinued or not. MR responded by advising that none of the existing property indices will be discontinued but instead FTSE/JSE has introduced new set of property indices to the existing suite.

8. RISK UPDATE AND LISTING SSF ON IPO DAY

SM stated that currently JSE doesn't list SSF on IPO day, SSF are listed after a certain period after the IPO as to gather a liquidity view on the underlying and assess the correlation in terms of finding a proper proxy for historical data and also assessing the behaviour of the stock itself, as to how to properly margin for the derivative of that particular stock with a proper risk framework for the particular derivative. SM highlights that JSE has seen an increase in demand to review their rules framework around IPO listing of derivatives, at the moment its being put together, IPO might end up being analysed on a case by case basis and JSE might need to put certain capital buffers around the IPO just to ensure that JSE is capitalised during the period. SM also stated that guidance from the FDAC would be much appreciated. It was agreed to add IDX in scope as well.

9. GENERAL

9.1. Update on Monthly Expiries

DN informed FDAC that a decision has been taken by JSE Exco to defer 'monthlies' post ITaC.

9.2. Update on SSF market making scheme

DN noted that a JSE has implemented a Zero Fee process for On-Screen SSF trades executed by the current market-maker to avoid consequences of a maker-taker pricing model applying adversely to the market-maker. A formal market maker programme will be introduced post ITAC go-live.

9.3. Time window for Option Exercise at FCO

VR reminded FDAC that currently the standing proposal tabled at TAC is 1pm, a 45 minutes window after the auction assuming that there is no extended auction time.

The FDAC committee requested the JSE to do a benchmark study on how other exchanges handle the Option Exercise processes, noting the right to abandon OTM option positions.