
MARKET NOTICE

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 Equity Derivatives
 Commodity Derivatives
 Interest Rate and Currency Derivatives
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SUBJECT: CONVENTIONAL GOVERNMENT BOND MTM METHODOLOGY

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INTRODUCTION

This note proposes a change to the current mark-to-market (“MTM”) valuation process for the benchmark bond (i.e. R186) and the other conventional Government bonds. The JSE determines a MTM yield for each of these bonds as a part of the end of day valuations process. This is currently done through a polling mechanism involving yields quoted by the Primary Dealers (“PDs”).

With the assistance of the newly formed Interest Rates Valuations Advisory Committee (“IRVAC”), the JSE has undertaken to review the MTM methodology and pricing formulae for all cash bond instruments, and this consultation tackles the first set of instruments in that process.

The proposal is a refinement to the current data collection and aggregation process rather than a fundamental rework of the MTM principles. It has been approved by the IRVAC and is presented to all interested market participants for comment. Any feedback will be carefully considered before making a final determination on changes to the existing MTM valuation.

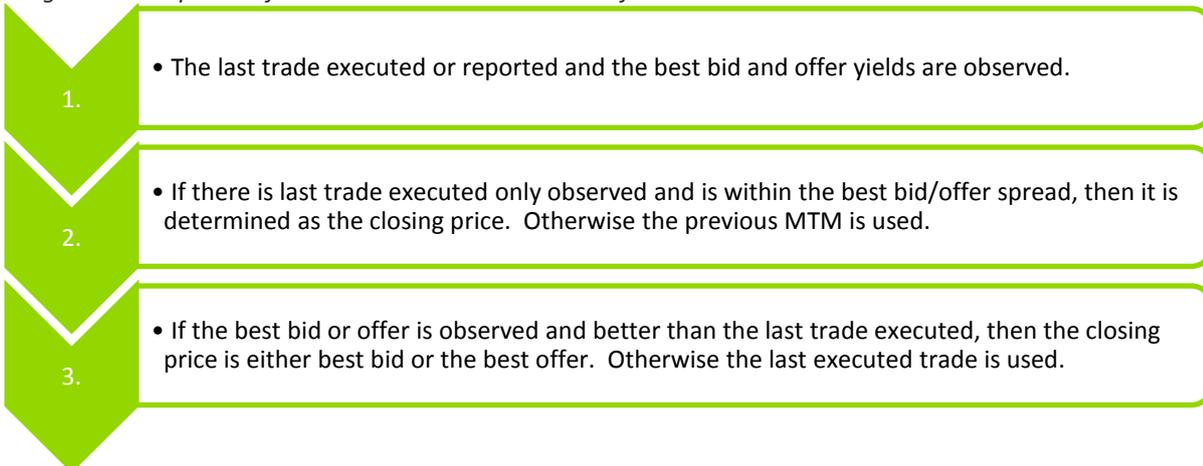
EXISTING PROCESS

The Benchmark Bond

The current end of day valuations process commences with determining the closing yield of the benchmark bond, currently the R186 maturing in 2027. The benchmark bond reflects the most liquid bond in the market, and can change from time to time in line with market dynamics. The JSE will review the selection of the benchmark bond on request from any market participant and in consultation with the PDs.

The MTM for the benchmark bond is determined at 16:30 by evaluating prices quoted on the Thomson Reuters pages of PDs. This is done on the basis of a snapshot analysis of last trade / better bid / better offer across all the contributors. This methodology is illustrated in diagram 1 below.

Diagram 1: The process followed in the MTM valuation of the benchmark bond

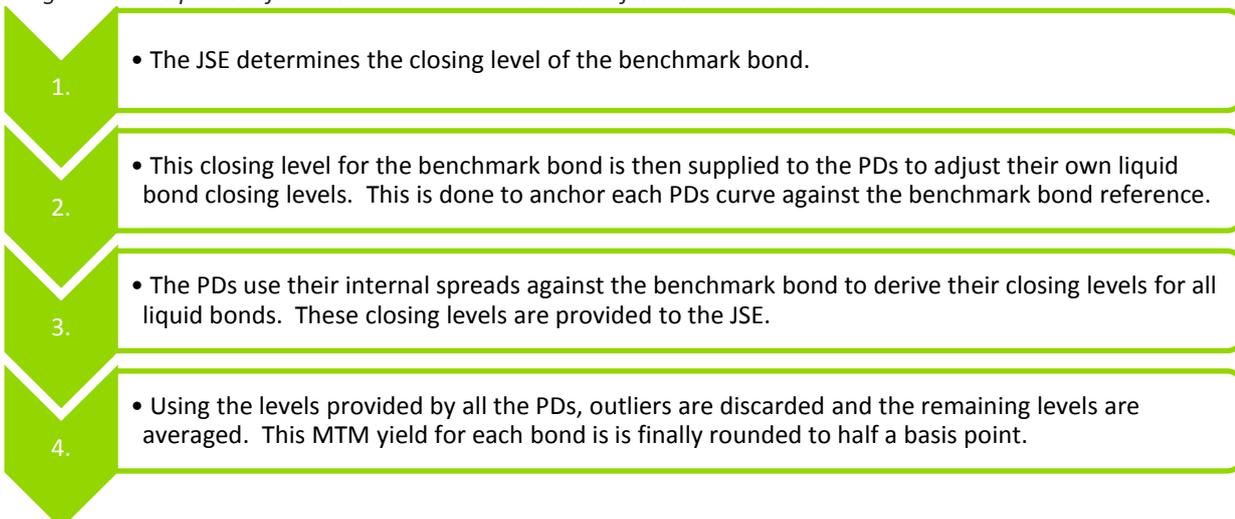


In effect, the process takes the last trade reported, compared to the best bid and the best offer across all contributors to determine the closing yield.

The Government Bonds

Once the closing yield for the benchmark bond is determined, the next task is to mark the set of liquid conventional government bonds, currently 16 in total (R159, R203, R204, R207, R208, R2023, R2030, R213, R2032, R2035, R209, R2037, R2040, R214, R2044, R2048). The liquid bonds are determined based on the high frequency of trades and currently they are made up of Government issues. The MTM valuation price of these bonds is established with the assistance of PDs via a call-down process. The process is illustrated in diagram 2 below.

Diagram 2: The process followed in the MTM valuation of Government bonds



While the majority of the rates are currently collected telephonically, data for some PDs is also collected from their Thomson Reuters pages.



The two highest and two lowest contributed yields for each bond are discarded before the final aggregation. Where there are fewer than 7 contributors to any particular bond, only the single highest and lowest closing yield is discarded. Where there are fewer than 5 contributors then no outliers are discarded.

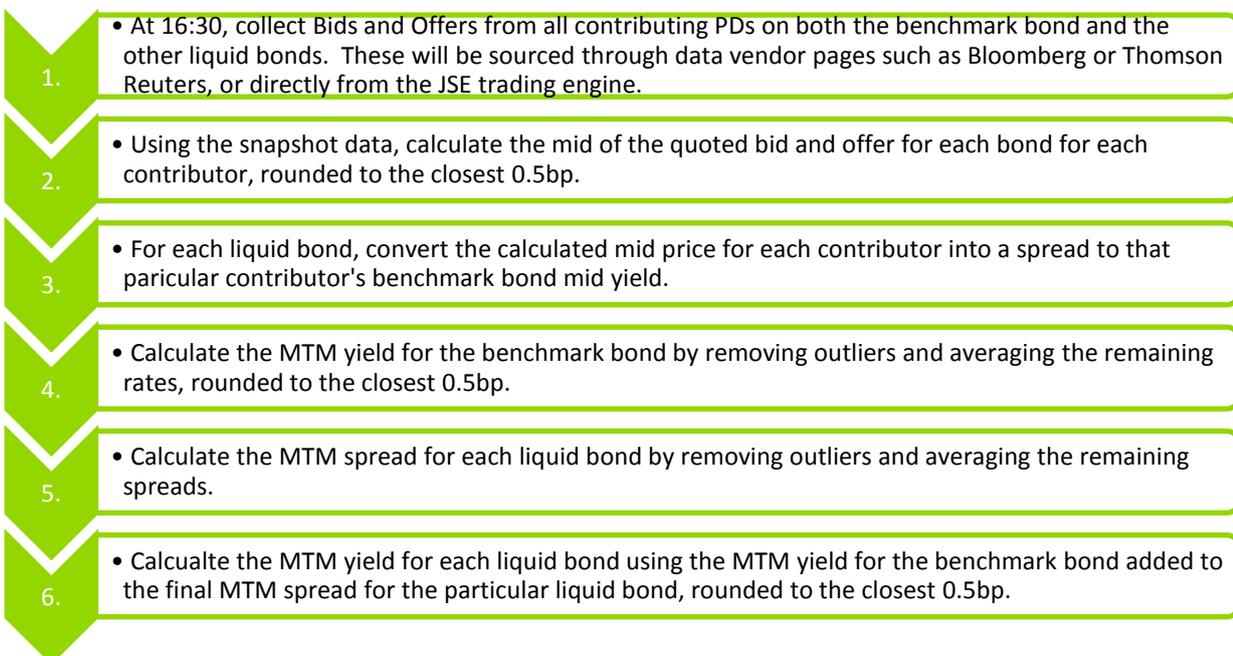
CONCERNS WITH THE EXISTING PROCESS

1. In order for the liquid bonds to be marked on a spread to the benchmark bond, the process relies on the PDs updating their yields based on the differential between the JSE's benchmark bond yield, and the PD's own benchmark bond yield. If this is not done, then all the rates provided by that PD will be determined on an inconsistent basis.
2. The determination of the benchmark bond yield is inconsistent with that applied to the other liquid bonds. The benchmark bond is priced on a last trade / better bid / better offer basis, whereas the other liquid bonds are priced on an average quoted yield.
3. There are a number of operational inefficiencies in using a telephonic process between the JSE and the PDs. In addition, there is currently no allowance to consider a broader range of quoted yields when sourcing PD rates.

PROPOSED PROCESS

The advent of the ETP will make a range of new price data available to the JSE to utilise in the valuations process. However, the JSE believes that it is appropriate to make methodology and process changes before then in order to improve the accuracy of the current offering. The proposal for changes is illustrated in diagram 3 below.

Diagram 3: The proposed MTM valuation process for the Benchmark bond and Government bonds



The removal of outliers will be done using the current process defined above. All averages are done on a simple arithmetic basis. All final MTM yields are rounded to the closest 0.5bp.

NEXT STEPS

The JSE has prepared this proposal to obtain commentary by market participants in the Interest Rate Market on the methodology and process followed in determining the MTM yield of the benchmark bond and other liquid bonds. While the proposed changes are not fundamental in nature, they do align the calculation basis for the benchmark bond to that applied for other liquid bonds, and allow the JSE to remove a number of operational inefficiencies.

It is important to the JSE to be aware of any impact to market participants as well as to identify all potential consequences of the proposal. Therefore, the JSE welcomes comments from any interested party. The JSE would also support discussions with market participants directly to discuss any further comments, suggestions or concerns, or to provide further context or analysis. Should you wish to arrange a meeting in this regard, please contact us at the email address provided below. All feedback will be carefully considered before making any final decisions.

Please provide your comments and suggestions by Friday 25 November 2016 to valuations@jse.co.za

The JSE will then finalise any changes to the methodology or process, considering the comments received. The JSE commits to implementing any necessary technical changes required in order to facilitate the updated process effectively. If there is any change to the methodology, then this will be published to the market with adequate notice before implementation.

Should you have any questions with regards to this notice, please contact valuations@jse.co.za

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