

MARKET NOTICE

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SUBJECT: PROPOSED IMPROVEMENTS TO THE CURRENT FUTURES AND OPTIONS MTM
METHODOLOGY APPLICABLE TO THE COMMODITY MARKET



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Dear JSE Stakeholder

Further to market notice A2015, thank you for all the comments and suggestions received particularly around the proposed option volatility methodology. The JSE would like to progress as follows:

1. **The proposed Futures MTM methodology received no negative comment and so will be implemented as from Tuesday 3 June 2014**

The futures mark-to-market methodology will therefore be updated as follows:

Futures MTM methodology

- MTM for the day, which is also referred to as the settlement price, will rely on a random sample selected any time in the last 5 minutes of trading at the discretion of the exchange.
- Based on the random snapshot selected, the MTM price is a function of referencing the last traded price **unless** there is a better bid or lower offer. If the closing bid is above the last traded price this will then be used MTM, alternatively if the offer is lower than the last traded price then the offer will be used as the MTM.
- Following this the spread relationship per product is determined across all expiries based on the sample set that was randomly selected.
- Then to recognize the liquid expiries within the MTM process, the most liquid expiry per product meeting the Volume Weighted Average Price (VWAP) criteria is selected as the reference from which all other expiries are adjusted by the spread difference, the following applies:
 - An expiry will be considered liquid on the trading day for the purpose of determining the MTM if 50 or more contracts trade during the last 15 minutes of a trading session
 - The spot month will not be included in the VWAP calculations and therefore never eligible to be considered liquid
 - Should multiple expiries per product meet this criteria, only the most liquid non spot month will be selected as the reference expiry month
 - Only on screen traded activity will be taken into account when determining the VWAP

- Please note the VWAP will not be taken into consideration on the day should the following occur, in which case the random snapshots will prevail:
 1. where at least one expiry of the contract series is MTM at the daily price limit, or
 2. when the VWAP has resulted in the MTM for any of the expiries of the contract series to be outside of the daily price limits.
 - Once the reference VWAP value is determined, it becomes the reference price from which all the other expiries are adjusted by the spread difference. This is done in order to maintain the same spread relationship amongst the contract expiries before and after the VWAP is recognized. In the event that no product has any expiries meeting the VWAP criteria, the random snapshot as selected will prevail without any further adjustments.
2. **Based on the feedback received, the suggested process to calculate the Option MTM Volatility requires more work in order to reach a wider consensus. The proposed methodology below will then first be simulated over the next 3 weeks and emailed daily to any interested parties in order to conclude on the way forward.**

In addition to the points previously raised, market participants should also recognize another important reason to ensure the option MTM volatility reflects current market related levels and therefore is more responsive, is to ensure from a risk assessment point of the view the options are valued correctly resulting in the correct variation margin flows.

Based on the feedback received and striving to reach common ground across the majority stakeholders, the JSE will consider onscreen trading activity during the last 2 hours of trading with a volume weighted average price of 20 or more contracts. The proposed methodology will then read as follows:

Options MTM Methodology

- Options traded **onscreen** over **the last two hours of the** trading session will be considered for the MTM process.
- Three strike prices either side of the option at the money will be considered eg if at the money strike is 1600, then 1540, 1560, 1580 and 1620, 1640 and 1660 strikes will be considered in the process.
- Should the Futures MTM be 1590, then an additional strike is included in the calculation process namely: 1520, 1540, 1560, 1580 and 1600, 1620, 1640, 1660
- **Provided there are 20 or more contracts traded across the strike range as described above, a volume weighted average price will be calculated to determine the option MTM volatility for the specific expiry month**
- **In the event less than 20 contracts traded across the strike range as described, the option MTM volatility will remain unchanged**
- In the event that the underlying future expiry month is priced limit up or down for a majority of the **last two hour trading period**, only options traded on the delta option window will be considered for MTM volatility purposes,
 - No options traded on price through the naked option window will be considered in this instance since the system generated volatility does not reflect the underlying futures price at which the option was matched,
 - Due to the price limits, should delta options only be considered for MTM volatility purposes then the same classification rules will apply **regarding a minimum of 20 or more contracts to calculate the VWAP**. If the criteria are not met the volatility will remain unchanged.
- The exchange reserves the right to make the final decision regarding the MTM volatility and may exercise its discretion as required.

During this trial phase, the JSE will email all the indicative option volatility MTM's to all contacts registered as option price makers, should you also be interested in receiving the information please send your request to commodities@jse.co.za.

As indicated the JSE will run the trial methodology through until Friday 20 June in order to compare MTM volatilities. Should there still be objections to the change following this review period we will then co-ordinate a meeting with all interested option market participants in order to agree a way forward. Option market participants are encouraged to continue providing feedback as we aim to ensure the MTM methodology for commodity options remains robust and a reflection of current trading levels for valuation purposes.

We appreciate and value your constructive feedback during this consultation period.