

MARKET NOTICE

Johannesburg
Stock Exchange

Tel: +27 11 520 7000
www.jse.co.za

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☐ Equity Derivatives
☐ Commodity Derivatives
☒ Interest Rate and Currency Derivatives
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SUBJECT: REPLACING THE R207 AND R208 GOVERNMENT BONDS WITH THE R2023 AS A COMPANION BOND FOR CORPORATE BOND VALUATIONS

Name and Surname: Mzwandile Riba
Designation: Head - Data Solutions

INTRODUCTION

The JSE is responsible for the valuation of all instruments listed at the exchange. Part of the universe of listed instruments are the numerous corporate bonds that fixed income market participants invest in. The diverse funding requirements of corporates lead to a market typified by the many different types of interest and capital repayment profiles that corporate bonds can adopt. While this flexibility is a positive attribute for different issuers, it does lead to a lack of liquidity per instrument, resulting in the infrequent observation of market prices.

The idea of **companion bonds** exists as method for providing non-static and market consistent closing prices for corporate bonds. A companion bond is generally a government bond that is similar in nature (generally with regard to duration) to the corporate bond it is linked to.

While the list of available government bonds still includes the R207 and R208, some inconsistent market activity in these two instruments has led to some difficulties in observing reliable market prices on the Electronic Trading Platform (ETP) for Primary Dealers (PD's) and elsewhere.

IMPORTANCE OF THE TRADED "SPREAD TO A COMPANION BOND" FOR MTM PURPOSES

The use of companion bonds requires for a spread between the traded yield-to-maturity (YTM) on a corporate bond and an observed, live YTM to its companion bond to be captured at the point of trade using the following formula:

$$\text{Traded Spread} = \text{Traded YTM on Corporate Bond} - \text{Live YTM of Companion Bond}$$

The traded spread is fixed until a future date when it is again observed via an eligible trade in the corporate bond or an available indicative double on one of the electronic vendor platforms. The YTM for the daily closing price of the corporate bond is taken as the closing YTM on the underlying companion bond plus the latest available traded spread. The YTM is then used to calculate the **All-in Price**, the **Clean Price** and all the other metrics of the corporate bond that are published by the JSE.

R2023 TO REPLACE THE R207 AND R208 AS COMPANION BONDS

Coming out of the corporate Bond workshops held by the JSE was the unanimous view that replacing both the R207 and R208 with the R2023 as a companion bond would be an appropriate course of action. The primary reasons for this being the more reliable price data of the R2023 and it being the closest duration government bond to the R207 and R208. The R2023 is one of the 5 obligatory bonds that the PD's have agreed with National Treasury to provide bids and offers for at all times on the bond ETP.

This option, while presenting a more reliable basis for companion bond market data, does present a duration mismatch between the slightly longer dated R2023 to the bonds currently linked to the R207 and R208.

GOING FORWARD

The JSE will implement this change on Monday the **24th of June 2019**. Importantly, the JSE will keep the resultant yields (and in turn the prices) of the corporate bonds constant by changing the spreads currently captured in the valuations system.

This document is not confidential and should be distributed as widely as possible to all stakeholders.

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