
MARKET NOTICEJohannesburg
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Relates to:

- Equity Market
- Equity Derivatives Market
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- Bond ETP Market

Date: 8 April 2022

SUBJECT: PROPOSED AMENDMENTS TO THE JSE EQUITIES RULES & DIRECTIVES – NEW MATCHED PRINCIPAL OFF BOOK TRADE TYPE

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Designation: Director – Market Regulation

Dear Client,

Members are advised that the proposed amendments to the JSE Equities Rules and Directives, attached as Annexure A, were adopted by the JSE Rules Committee on 07 April 2022.

The purpose of these proposed amendments to the equities rules and directives is to enhance the interoperability between the JSE and other local exchanges, such as A2X, when common members of the exchanges trade cross-market in dual-listed securities on behalf of clients.

It has come to the JSE's attention that when a member trades cross-market on both the JSE and A2X in filling an institutional client's order, the institutional clients are unable to process separate allocations and settlement instructions in their systems for the trades on each exchange. To use market terminology, the institutional clients require a "single contract note" in respect of their allocated trades on both exchanges. However, each exchange is required to manage the settlement of trades on its own market. Therefore, the allocated trade legs that reside in the JSE's post-trade systems, and that are subject to monitoring by the Settlement Authority and the application of the JSE's settlement assurance measures, need to relate to trades executed on the central order book of the JSE equities trading system or reported to the JSE trading system. The JSE cannot manage the settlement of trades executed on A2X nor can the JSE permit the settlement of JSE trades to be managed by A2X. The challenge of providing institutional clients with a single contract note whilst still enabling the JSE to manage the settlement of its own trades therefore requires a solution. The proposed amendments to the rules and directives give effect to such a solution.

The proposed solution involves the introduction of a new off-book trade type called a Matched Principal trade. It involves a member interposing itself as a principal in trades with the market executed in the fulfilment of an order received from a client. Importantly, the trades with the market and the back-to-back matched principal trade with the client must be at the same price. The member may not make a profit on a matched principal trade other than through charging the client an agreed, disclosed fee.

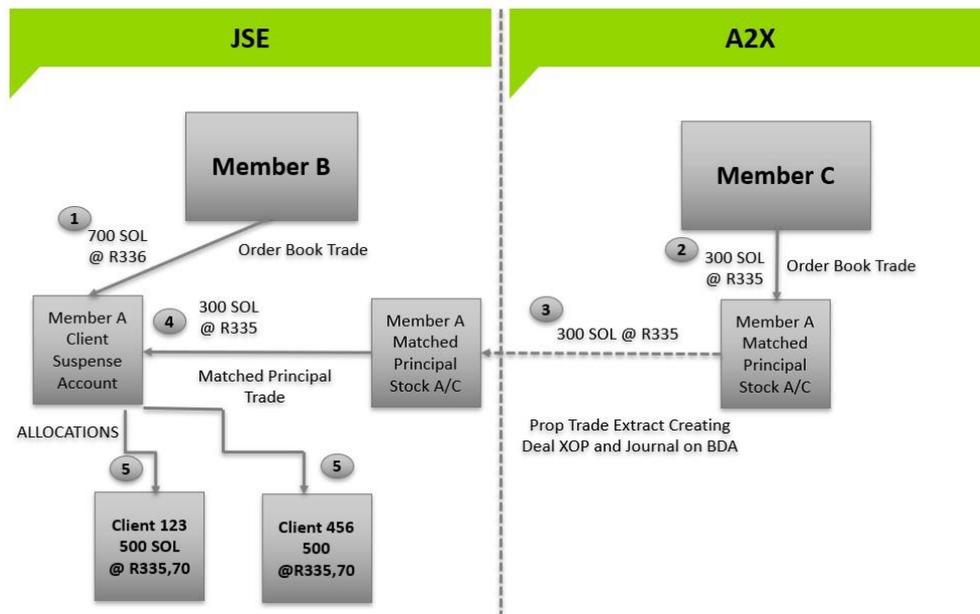
In the context of a member trading across both the JSE and A2X in the fulfilment of an order received from an institutional client, and where the member facilitates the “consolidation” of this cross-market trading for the purpose of issuing a single contract note by using the new Matched Principal trade type on the JSE, the member would do the following:

- Trade into a dedicated client suspense account in the name of the institution on the JSE, in respect of the equity securities bought or sold on the JSE central order book in the fulfilment of the client’s order
- Trade into a Matched Principal stock account on A2X, in respect of the equity securities bought or sold on the A2X central order book in the fulfilment of the client’s order
- Report a Matched Principal off-book trade to the JSE trading system between the member’s Matched Principal stock account on the BDA system and the client suspense account, which is an equal but opposite trade to the trades in the Matched Principal stock account on A2X
- Allocate the aggregated JSE central order book trades and the reported Matched Principal trade on the client suspense account to the underlying clients of the institution at the average price of those trades

An illustration of the above scenario is set out below. In this example –

- An institutional client places an order with Member A to buy 1000 SOL shares
- Member A buys 700 SOL on the JSE at R336 from Member B
- Member A buys 300 SOL on A2X at R335 from Member C
- Member A reports a Matched Principal trade with the client to the JSE trading system for 300 SOL at R335 (ex A2X trade)
- Member A allocates 1000 SOL to two underlying clients of the institution at the average price of the JSE order book and Matched Principal (ex-A2X) trades (R335,70), and issues a single contract note for each allocation

Example of JSE/A2X cross market trading



The JSE has established an arrangement with A2X in which common members are able to extract their proprietary trades from the A2X post-trade systems and upload them into the BDA system via Deal XOPs and journals. This arrangement enables the member to balance their proprietary holdings in their accounting records with their securities account at their CSDP. It also facilitates an accurate calculation of the member’s capital adequacy requirements in the JSE’s capital adequacy system. Leveraging off this existing arrangement, a member that has traded on a Matched Principal stock account on A2X will be able to upload those proprietary trades into its Matched Principal stock account in the BDA system used for the reporting of Matched Principal trades on the JSE. This will result in a zero net position on the Matched Principal stock account in BDA, and will ensure that the order book trades on A2X and the Matched Principal trade on the JSE are at the same price, as the proposed new rule requires.

In the scenario above, step 3 reflects the extract of the 300 SOL bought on Member A’s Matched Principal Stock account on A2X from the A2X system and the upload of that position into a Matched Principal Stock account in the BDA system.

A contract note issued to a client is required to indicate the capacity in which the member traded – either as an agent or a principal. In generating a single contract note using the mechanism described above, the contract note will effectively represent a combination of agency and principal trades, as a portion of the institutional client’s order will have been filled through agency trades on the JSE and the balance of the order will have been filled through a Matched Principal trade (ex-A2X trades). There is currently no mechanism to reflect the split between agency and principal trades on a single contract note. Therefore, the member will have no choice but to reflect on the contract note that the capacity in which they have traded is as an agent. This is not optimal but, under the circumstances, the JSE is comfortable with this disclosure, as a Matched Principal trade has the same economic effect as an agency trade, in that the principal trade with the client is at the same price as the originating market trade executed in the fulfilment of the client’s order. Most importantly, through the standard practice of real-time reporting of cross-market executions to institutional clients by members, the clients will know that each execution that ultimately makes up a contract note is



with a market counterparty at the best available price in the respective order books. The member will not have traded with the client as a principal at a different price to the price at which the member may have traded with the market for its own account, as would typically be the case with other principal trades.

It is important to note that a Matched Principal trade reported to the JSE trading system may only relate to originating trades on the central order book of another local exchange. It may not relate to other trades on the JSE, because the Matched Principal trade is being introduced solely to facilitate cross-market trading and settlement. It may also not relate to off-order book trades on another exchange because, for risk management purposes, the JSE requires the single contract notes in respect of cross-market trades to represent originating trades executed on the JSE or A2X central order books at the order book price. The JSE cannot manage settlement risk effectively if a single contract note represents a combination of trades at an order book price and trades at a price negotiated off-order book. However, although the single contract note that will be issued represents the allocation of a combination of JSE central order book trades and an off-order book principal trade reported to the JSE trading system - which appears to compromise the principle of ring-fencing of off-order book trades for settlement purposes - under the circumstances, the JSE is comfortable with this practice because the off-book Matched Principal trade will always originate from an on-book trade at an order book price, albeit on the A2X central order book.

The effect of the Matched Principal trade mechanism is that an institutional client will be issued with single contract notes in respect of trades that originated on multiple exchanges. But importantly, despite the Matched Principal trade effectively combining trades across multiple exchanges from a contract note point of view, from the point of view of managing settlement, each exchange will monitor its own trades executed and reported within its own environment. Therefore, although a Matched Principal trade reported to the JSE trading system originates from trades on another exchange, the JSE will not be managing the settlement of the originating trades on the other exchange. Although the JSE will be aware that there are cross-market dependencies from a settlement point of view, given that a Matched Principal trade is a back-to-back trade to trades on another exchange, the JSE's main focus from a risk management perspective will be on the trades executed within the JSE environment and residing in the JSE's post-trade systems. The JSE will therefore view the Matched Principal trade as the co-origin of the trades allocated to the underlying clients of the institution, together with the trades executed on the JSE central order book on behalf of those clients, and will risk manage it accordingly. Directive EM 2.4 states that certain off-book trades that are deemed to have an impact on on-book trades will be margined. Given that the client will receive a single contract note that will not distinguish between the JSE central order book trades and the Matched Principal trade that collectively make up the contract note, to ensure as far as possible that the client's trade will settle it is prudent to manage the Matched Principal trade as if it was an order book trade. Therefore, the Matched Principal trade on the member's Matched Principal stock account on the BDA system will be margined.

It is the JSE's intention to enable members to create a new type of stock account on the BDA system with a unique Account ID for Matched Principal stock accounts. This will facilitate effective trade surveillance by the Market Regulation Division and may also have other benefits. However, it is possible that the new Account ID will not be available in the BDA system by the time the proposed rule and directive amendments are approved and members are able to commence using the Matched Principal trade type. Therefore, in the interim, until the JSE introduces the new Matched Principal Account ID, we are proposing the introduction of new Directive BI 8 which requires members to name their Matched Principal stock accounts appropriately, for the reasons set out in that proposed directive. Once we introduce a unique Account ID for Matched Principal stock accounts we will make the necessary further amendments to Directive BI, including any consequential amendments to the new Directive BI 8.

We have inserted the new Matched Principal Trade in the Ring-Fencing schedule in Directive EL. In further examining this schedule we have concluded that the content of the column headed 'Risk Managed by the JSE' is confusing when read with certain settlement rules. For example, rules 10.40.1.1 and 10.40.1.2 state that the Settlement Authority will manage the risks associated with the settlement of central order book and off-book transactions. These rules correctly give the Settlement Authority the power to manage the risks associated with the settlement of all JSE trades, and not only central order book trades, because the Settlement Authority must have the discretion to assess which trades pose a direct or indirect risk to the settlement of central order book trades and be able to act appropriately. Therefore, it is

not correct to state in the schedule in Directive EL that no off-book trades are 'risk managed by the JSE', as the schedule currently states. We are therefore proposing to delete this particular column from the schedule.

Unless written objections are lodged within 10 days of this notice, in terms of rule 2.60.3, the proposed rule amendments will be submitted to the Registrar for his approval.

Should you have any queries regarding this Market Notice please contact Shuayb Mohamed on (011) 520 7824 or at ShuaybM@jse.co.za

This Market Notice will be available on the website at <https://www.jse.co.za/redirects/market-notice-and-circulars>