

## MARKET NOTICE

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**Relates to:**  Equity Market  
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**SUBJECT:** PROPOSED MARK-TO-MARKET METHODOLOGY FOR LIQUID GOVERNMENT BONDS

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### 1. INTRODUCTION

The JSE determines closing prices on a daily basis for all listed instruments at the Exchange. This notice provides the proposed methodology to be used for the valuation of liquid government bonds. The JSE wishes to notify the market of its intention to switch, with effect from Friday, **1 March 2019**, from the current primary dealer call-down process to using data sourced from the **Electronic Trading Platform (ETP)** for liquid government bonds.

### 2. CURRENT MTM VALUATION PROCESS (CALL-DOWN PROCESS)

The exchange currently determines the closing level of the benchmark R186 government bond at **15h00** and also at **16h30** which is then communicated to each of the primary dealer banks via a phone call. The primary dealers use this benchmark level to derive closing levels for the other liquid government bonds. This is done by applying spreads to the other liquid government bonds from the given level of the R186. The levels determined by this process are communicated to the JSE during the same phone call.

The next step is to remove the outliers (highest and lowest level) from the data received from the primary dealers and then to average the remaining data to establish the MTM value for each of the government bonds. This level is then rounded off to the nearest half basis point.

The liquid bonds are those bonds for which the primary dealers make a market as per the agreement between National Treasury and the primary dealers themselves. These bonds currently comprise the most liquid government issues, namely the R186, R207, R208, R209, R213, R214 R2023, R2030, R2032, R2035, R2037, R2040, R2044 and the R2048. The primary dealers are currently only **obliged** to make markets in five bonds, namely the R2023, R186, R2032, R209 and the R2048. There is currently no obligation to quote on the remainder of the bonds listed above although tradeable bids and offers are generally provided in order to facilitate market liquidity.

### 3. PROPOSED BOND ETP MTM PROCESS

The ETP is a centralized electronic order book that offers price transparency and anonymous trading for the primary dealers on selected South African government bonds. The JSE proposes introducing the use of the ETP for MTM purposes to replace the current call-down process by taking a snapshot of the bids and offers on screen and computing the mid.

A random snapshot of the bids and offers of all the bonds on screen will be taken at any point between **16h25** and **16h35** for the end of day MTM process. On a bond futures closeout day, a further random snapshot will be taken at any time between **11h55** and **12h05**.

- The MTM level is then simply taken to be the mid of the observed double at the time that the snapshot is taken.
- In the absence of an active double, any available trade data will be given preference following the process defined in paragraph 4 below.
- The resultant MTM levels will then be rounded off to the nearest half basis point to maintain the same level of numerical accuracy as the current process.

The JSE additionally provides valuations for the Unit Trust Mark to Market process at **15h00**. A similar process will be followed to that of the end of day MTM process.

### 4. LACK OF SCREEN PRICES AND/OR TRADES IN THE LESS LIQUID BONDS

In the event that there are no trades executed on the day or on screen prices are not provided for the bonds for which the primary dealers are not obliged to quote, the following will be done:

- i. The JSE will allocate each of the five bonds, for which the primary dealers are obliged to quote, to term buckets into which their current term to maturity lies. These five bonds are currently assigned to maturity buckets as below. The relevance of these term buckets will be observed on an ongoing basis for their applicability and will be adjusted accordingly if needs be. This would essentially coincide with any changes that are made to the list of obligatory bonds:
  - 0 to 5 years – R2023
  - 5 to 10 years – R186
  - 10 to 15 years – R2032
  - 15 to 20 years – R209
  - 20 years and beyond – R2048
- ii. The less liquid bonds would then be paired with one of the five bonds above based on the maturity bucket corresponding to the bonds' term to maturity.
- iii. The yield spread between the less liquid bond (whose MTM cannot be determined using the ETP MTM process outlined above) and the liquid bond in the corresponding maturity bucket is then computed based on the previous day's MTM.

- iv. This spread is then added to the liquid bond's MTM yield to obtain the MTM valuation of the less liquid bond.
- v. The spread that is used in this process will continue to be used for that particular bond's valuation until a trade or tradeable screen prices are observed as per the Bond ETP MTM process outlined above.
- vi. Any changes to the list of government bonds that are actively quoted and traded on the ETP as agreed between National Treasury and the primary dealers, will be noted by the JSE as part of an ongoing process. The JSE will as accurately as possible adjust to these changes as and when they occur.
- vii. An analysis of ETP data indicates that it is especially the two short dated bonds (**the R207 and the R208**) that may not exhibit on screen prices due to the relative lack of liquidity.

**NB:** The use, as described above, of the five liquid bonds in their corresponding maturity buckets, should in no way be confused with the assignment and use of **companion bonds** by bond issuers.

The primary dealers have been active in providing prices for the non-obligatory bonds. Outside of the lack of on screen prices observed for the R207 and R208 for the reasons noted above, the rest of the bonds are quoted actively and will thus generally be relied on for the mark-to-market process. The above method is thus only envisaged for the extreme case where such prices are not available on screen.

## 5. NEXT STEPS

The JSE has prepared this proposal in the belief that using a more transparent methodology which utilises executable market values in the bonds MTM will result in a material improvement in the quality of the published price. The proposed process is not more complex than the current process, but should deliver an improvement in accuracy. Furthermore, the proposal utilizes the same list of primary dealers that are currently contributing to the MTM determination. Notwithstanding the methodology presented in this guide, the JSE reserves the right to make a final decision regarding the valuation of any listed security. In particular, the JSE may deviate from this methodology in the event of non-standard market hours, technical issues with pricing systems, or observed anomalies in market data.

It is important to the JSE to be aware of the impact to all market participants as well as to identify all potential consequences of the proposal. All feedback will be carefully considered before making any final decisions. Therefore, the JSE requests comments from any interested party.

Please provide your comments and suggestions by Friday, **15 February 2019** to [valuations@jse.co.za](mailto:valuations@jse.co.za). The Bond ETP, while providing a trading platform for the primary dealers, is available to all market participants for viewing purposes.

Should you require any subscription information, please contact [MDSupport@jse.co.za](mailto:MDSupport@jse.co.za). This document is not confidential and should be distributed as widely as possible to all stakeholders.

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