MARKET NOTICE

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Relates to:	☐ Equity Market ☒ Equity Derivatives ☒ Commodity Derivatives ☒ Interest Rate and Currency Derivatives
Date:	4 February 2019
SUBJECT:	**JSE CLEAR INITIAL MARGIN METHODOLOGY REVIEW**
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Dear JSE Stakeholder

Initial margin (IM) represents a CCPs primary prefunded line of defence against potential losses in the event of a clearing member default. Accordingly, JSE Clear (JSEC's) regularly reviews its IM model in order to assess its continued level of suitability. Accordingly, the JSE recently completed a review of the methodology currently used to calculate contract level IM requirements.

The following table provides an overview of the methodology currently used to calculate contract level IM requirements in all the markets cleared by JSE Clear:

The loss model	Liquidation Period	Look-Back Period	Confidence Level
Historical Value-at-Risk (VaR), with returns normalised (scaled) to the current volatility environment.	2-days, more initial margin is required for positions that will take longer than 2 days to liquidate.	Rolling 3-year period supplemented with a 1-year stressed period.	99.7% one-sided confidence level.

Table 1: JSE Clear contract level IM parameters

The review found that the above-mentioned methodology is broadly aligned to JSEC's philosophy towards risk. However, the process of scaling the set of historical returns to the current volatility environment could introduce procyclical features. An anti-procyclical IM philosophy is strongly encouraged by regulators, and should be embraced by all risk management practitioners. Excessive IM calls during periods of stress can result in a significant liquidity burden for market participants, which could in turn force participants to liquidate derivative positions that are acting as hedges against other exposures – which could in turn force participants to reduce the exposures which they are looking to protect. A vicious cycle which could, in turn, exacerbate the stressed market environment and the financial position of the affected parties.

Against this backdrop, the JSE Clear Risk Committee approved a framework whereby any form of volatility scaling will be removed from the IM calculation framework. Instead, the model will only make used of actual historically observed returns. The change in methodology will be implemented according to the following staggered approach:

- Monday 18 February 2019: introduce a limit whereby historically observed returns cannot be scaled up or down by more than 20%;
- Monday 25 February 2019: introduce a limit whereby historically observed returns cannot be scaled up or down by more than 15%;
- Monday 4 March 2019: introduce a limit whereby historically observed returns cannot be scaled up or down by more than 10%;
- Monday 1 March 2019: introduce a limit whereby historically observed returns cannot be scaled up or down by more than 5%;
- Monday 18 March 2019: introduce a limit whereby historically observed returns cannot be scaled up or down by more than 0%

The spreadsheet which accompanies this notice illustrates the contract level impact associated with the methodology change.

Should you have any queries regarding this notice, please contact **risk@jse.co.za**
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