

MARKET NOTICE

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Relates to:

- Equity Market
- Equity Derivatives Market
- Commodity Derivatives Market
- Currency Derivatives Market
- Interest Rate Derivatives Market
- Bond Market
- Bond ETP Market

Date: 24 June 2021

SUBJECT: IMPLIED SPREADS FOR JSE LISTED FIXED-RATE CORPORATE BONDS

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1. INTRODUCTION

The closing price of JSE listed fixed-rate corporate bonds is determined relative to a companion bond. A companion bond is generally elected by the issuer, as a government bond of similar term to maturity to the corporate bond being listed. The relationship between a corporate bond and its companion bond is denoted by a spread (expressed in basis points) to the yield-to-maturity (YTM) of the companion bond. Due to the illiquid nature of corporate bonds, this relationship with their companion bonds allows for the change in corporate bond yields as market conditions change over time.

Trading members have the obligation to capture the spread to the companion bond when concluding a trade in a fixed rate corporate bond. When this is not done, the closing price calculation will refer to the prevailing spread, which is the spread that was captured when the instrument was last traded. This may imply that an incorrect spread is then be used for the purposes of the calculation of the closing price.

2. CALCULATION OF THE IMPLIED SPREAD

On occasion, trading members do not capture the spread to a companion bond. When the spread is different from the previously captured spread on the instrument, this may lead to the calculation of a closing price not in line with where the instrument traded and where the market would expect it to be marked.

The Valuations team has resolved to calculate an “implied spread” in the absence of the traded spread. This will be taken as the difference between the prevailing yield of the companion bond and the yield on the corporate bond captured in the trade details. The government bond yields that will be used are those relating to the 3pm cash bond valuation conducted daily by the Valuations team.

The formula for the implied spread can simply be expressed as:

$$\text{Implied Spread}_t = \text{Traded Yield on Corporate Bond}_t - \text{Yield on Government Bond (3pm)}_t$$

The implied spread, as calculated, will then be used in the daily “waterfall process” which also takes broker bids and offers into account when determining the MTM spread for the instrument in question.

3. FIXED RATE BONDS WITHOUT A COMPANION BOND

The Valuations team will also embark on an additional exercise to identify the fixed rate bonds that may have been listed with the omission of a companion bond. As part of a periodic exercise, the appropriate companion bond (based on term to maturity) is identified for the instrument and duly assigned.

4. IMPLEMENTATION

The implied spread calculation will be implemented from **Monday, 5 July 2021**. While this may not be a perfect solution, the intention is to get as close as possible to the traded spread. The ideal situation is where trading members capture spreads at the point of trade to ensure the calculation of the correct closing prices in line with market activity.

The process to assign companion bonds to fixed rate bonds without one, is a manual process that will be completed by the team by **Friday, 30 July 2021**. A market notice will be sent out to all stakeholders informing of the changes made.

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

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

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