

## MARKET NOTICE

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**Number:** 321/2021  
**Relates to:**  Equity Market  
 Equity Derivatives Market  
 Commodity Derivatives Market  
 Currency Derivatives Market  
 Interest Rate Derivatives Market  
 Bond Market  
 Bond ETP Market  
**Date:** 4 August 2021

**SUBJECT:** **PROPOSED CHANGES TO RANDOM ALLOCATION ALGORITHM FOR PHYSICAL DELIVERIES  
IN COMPLETION OF A FUTURES CONTRACT**

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Dear Client,

### Probability of being randomly allocated

The JSE has been receiving queries from trading members and their clients, complaining about disproportionate allocation of physical deliveries on their long positions when their position only makes up a small % of the open interest. There was a strong suspicion from the market that the random allocation methodology was flawed and incorrectly programmed, however the JSE, working with the software vendor, have continued to validate the programming code. We can confirm that there is nothing incorrect with the code that has been in production since 2011 and is indeed random.

The random allocation process follows two criteria:

1. Long position holders having futures positions that are equal to or greater than the tonnages of the silo receipt being delivered, have **an equal chance of being randomly allocated** per individual silo receipt.
2. If no position exists that is equal to or greater than the silo receipt tendered, the silo receipt will be split into the standardized contract size and allocated randomly on an individual basis.

From the criteria above, it is evident that the random allocation algorithm does not consider the percentage of open interest a client holds when allocating silo receipts. The market is now requesting the JSE to consider random allocation probability, instead of being equally weighted, must be proportionate to clients' long positions as a percentage of total open interest.

Let's provide some perspective by way of an example:

Consider a silo receipt of 10 contracts to be delivered. Then consider the following long position holders:

- A - 100
- B - 50
- C - 20
- D - 3
- E - 1

The open interest is 174 contracts, but since the silo certificate to be delivered is for 10 contracts, we will eliminate the last two positions held by clients D and E and only allocate to clients A, B and C. This means qualifying open interest is now 170 contracts.

Therefore, the respective probabilities of being assigned physical stock for the three remaining long position holders are as follows:

- A:  $100/170 = 59\%$
- B:  $50/170 = 29\%$
- C:  $20/170 = 12\%$

Under our existing random allocation process, the above probabilities would be the same for each client, however with the proposed change it is evident that for client C with the smallest number of long positions, the probability of being allocated the silo receipt is significantly reduced. The proposal is that the JSE will continue to make use of the random selector however based on the clients' long position, the probabilities will be adjusted based on the size of the open interest.

There was a discussion at the recent Advisory meeting to also consider reducing the maximum issued silo receipt size from 1000 tons to 500 tons however there was concern raised around the increased impact on administrative activities for the members involved with physical deliveries. After the JSE investigated this potential impact and confirmed that currently just over 21% of all deliveries are greater than 500 tons, the JSE has decided not to reduce the maximum JSE silo receipt size from the current 1000 ton limit at this point in time.

**Random allocation to client accounts of the same legal entity,**

Another request from the market is that the JSE revisits the random allocation process when dealing with multiple accounts belonging to the same legal entity.

Clients with multiple accounts face a challenge when retendering a silo receipt on the Spot Basis platform, where the same location is allocated to the same client via a different account the following day. Currently, the algo used for random allocation does not check the client details when allocating silo receipts hence this challenge for clients with multiple accounts. Essentially, as things stand now, the random allocation process could deliver a client its own stock back, something the market is requesting that we look into.

**The JSE is already in discussions with the system vendor to assess the impact of such a possible change. We are therefore soliciting support from the market to proceed with the proposed changes and, unless there are any reservations raised by the latest 13 August 2021, the JSE will proceed and inform the market on the technical impact and when the expected implementation is envisaged.**

Should you have any remaining questions please do not hesitate to contact the Commodities Team at 011 520 7039 or email [commodities@jse.co.za](mailto:commodities@jse.co.za)

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