JOHANNESBURG STOCK EXCHANGE
SAFEX Commodity Derivatives

Market Notice

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Proposed changes to the futures mark-to-market methodology to recognize calendar spread relationships.

In summary the current daily futures mark-to-market (mtm) procedure is applied as follows:

Snap shots

Snap shots are taken at random every minute for the last 5 minutes before 12h00 of every trading day. Anyone is randomly selected to determine the m-t-m price for the day for each of the listed contracts.

VWAP

In addition to the above, we also look at the Volume Weighted Average Price (VWAP). A contract is said to be liquid on a particular trading day if 100 or more contracts were traded during the final 30 minutes of the trading session. The contract will be considered illiquid otherwise and snap shots will be used.

If contract was liquid, then the VWAP value is taken as the m-t-m price instead of the screen dump as outlined above. This means that only traded prices are taken into account when determining m-t-m for liquid contracts, and assignments, net-offs and corrections are not included in the process.

Even though we have used this procedure for quite some time now, it has proven to be a challenge especially in recognising the valuation of spread trades, as we will show below. Quite a number of industry participants have suggested that this approach be revisited to ensure the daily valuation process strives to reflect more accurately the spread relationship between the various calendar months.

At a recent Agricultural Advisory Committee meeting held on 18th October 2012, the Committee resolved to allow the JSE to run an improved futures mtm methodology based on the following criteria:

- Snap shots will be taken as before during the last 5 minutes before 12h00 of every trading day in order to determine the mtm spread relationship.
- Instead of VWAP of 100 contracts traded during the last 30 minutes, we will look at **50 contracts traded during the last 15 minutes**. This will determine the "liquidity" criteria.
- In the event that we have more than one liquid expiry month for a particular commodity, **the most liquid of the two** will be selected.

- We then determine the **difference between the mtm price and the VWAP value** of the same contract expiry and all the other expiries will be adjusted by this difference. This is done in order to maintain the same spread between contract expiries before and after VWAP is implemented
- In the unlikely event that some expiries are locked at the price limit whilst there is no bid or offer on others to maintain the spread relationship, the JSE will then rely on the same spread relationship from the previous day to mtm the illiquid expiry
- The above proposal will be tested across all grain products on a month trial basis.

We can best describe the challenges by looking at real experience in the past. Let's take a look at WHEAT contract on the 23 August 2012:

WHEAT	MtM	MtM Spread	VWAP MtM	VWAP Spread	Proposed MtM	Resultant Spread
Aug-2012	3480.00		3480.00		3464.00	
Sep-2012	3500.00	20.00	3484.00	4.00	3484.00	20.00
Dec-2012	3525.00	25.00	3518.00	34.00	3509.00	25.00
Mar-2013	3590.00	65.00	3590.00	72.00	3574.00	65.00

From the table above, we see that the normal mark-to-market prices for those wheat contract expiries are given in the second column. The Aug12-Sept12 spread is R20/t; Sept12-Dec12 is R25/t and Dec12-Mar13 spread is R65/t. On that particular day, both the Sept12 and Dec12 expiries traded 621 and 108 contracts respectively within the last half hour. In terms of our marked to market pricing, the two contracts were liquid and hence the VWAP values for both will be taken as the mtm price of the day. Refer to 4th column above.

Without saying the obvious, the main challenge presented by the table above is the difference in contract spreads as obtained from the normal mtm approach on the one hand, and from the VWAP approach on the other. The Aug12-Sept12 spread for example would have shrunk from R20/t to only R4/ton, and this is what we are trying to address.

You will observe from the table that the resultant spread values in the last column are exactly the same as the m-t-m spread values in column 3. In other words, even though we have adjusted our mtm prices with VWAP values, the spreads between expiries were not compromised

In order for market participants to appreciate the potential impact to the futures mtm methodology the information will be published alongside the existing mtm and distributed via email to all registered users in the database. This process will commence from Monday 29 October 2012 through until Friday 30 November 2012.

Members are encouraged to compare current mtm prices with potential mtm prices and submit any comments and/or observations where applicable. Based on the feedback and further consultation with the Agricultural Advisory Committee a final ruling will then be published early December should the proposal be accepted.

Should you have any queries regarding the proposed futures mark-to-market process, please contact the Commodities Team on 011 520 7258 or e-mail commodities@jse.co.za

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