

Market Notice

Number: A1717

Date 13 November 2012

Proposed changes to the option volatility m-t-m process including option reported trade types

Further to an options workshop held on the 5th November with a number of market participants there was support to amend the current option volatility m-t-m process as follows:

- Further define a specific period when only delta options traded will be considered for m-t-m purposes
- On limits days when traded delta options are considered, the exchange will no longer reference any bids or offers on the delta screen as a last resort to update the m-t-m volatility

The following methodology is therefore proposed with the latest changes highlighted in yellow:

- Options traded over the last hour of the trading session will be considered for the m-t-m process.
- Three strike prices either side of the option at the money will be considered eg if at the money strike is 1600, then 1540, 1560, 1580 and 1620, 1640 and 1660 strikes will be considered in the process.
- **Should the Futures MTM be 1590, then an additional strike is included in the calculation process namely: 1520, 1540, 1560, 1580 and 1600, 1620, 1640, 1660**
- If 60 or more contracts have traded across all **available** strikes for the entire day, the contract will be considered liquid.
- The opposite applies to illiquid contracts, if less than 60 contracts across all **available** strikes have traded for the entire day then the contract is classified illiquid.
- If classified as liquid, then a volume weighted average of 40 or more contracts across the selected strikes will be required in the last hour of trade as the m-t-m volatility, if this quantity does not trade then the volatility will remain unchanged.
- If classified as illiquid, then a volume weighted average of 20 or more contracts across the selected strikes will be required in the last hour of trade for the m-t-m volatility, if this quantity does not trade then the volatility will remain unchanged.
- **In the event that the underlying future expiry month is priced limit up or down for a majority of the period between 11h15 and 11h45, only options traded on the delta option window will be considered for m-t-m volatility purposes,**
 - **No options traded on price through the naked option window will be considered in this instance since the system generated volatility does not reflect the underlying futures price at which the option was matched,**
 - **Due to the price limits, should delta options only be considered for m-t-m volatility purposes then the same classification rules will apply regarding the use of the liquid or illiquid classification criteria, namely 40 or more contracts required for liquid months whilst 20 or more contracts for expiries meeting the illiquid month classification. If the criteria are not met the volatility will remain unchanged.**
- The exchange reserves the right to make the final decision regarding the m-t-m volatility and may exercise its discretion as need be.

Please could market participants review the proposed changes and provide comments via email directly to commodities@jse.co.za no later than **Friday 30 November 2012**. Provided no objections are received the



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JSE will then move to implement the new methodology as from December 2012 together with the changes to the futures m-t-m process which recognizes the calendar spread relationship more closely.

In addition to the above changes, it was also agreed at the same meeting to enhance the requirements for Delta Option Trades (DOT) and Structured Option Trades (SOT). In essence both reported trade types, provided they meet the exchanges reporting requirements, will be processed up until 12h30 each day. Although the underlying grain futures market will be closed by then the option information will continue to be reported via the trading front end. It is also imperative to note these reported trades will not be considered for option volatility m-t-m purposes.

A summary of the two report only trade types are as follows:

1. Delta Option Trades (DOT)

Please note these transactions do not relate to trades matched on volatility where each party automatically receives the delta equivalent futures. Due to the risk that the futures price may move significantly after the option writer has secured the necessary deltas, resulting in the current quoted option premium being away from the agreed premium levels. The two parties are then exposed to the risk of being able to execute the option strikes at the original agreed price without a third party matching one of the legs to the structure. This risk increases as more automated systems enter the market and dynamically re-price options as the underlying moves.

To address this specific risk the JSE provides participants with the reported trade type namely "Delta Options Trade" (DOT), which will require participants to comply with the below requirements:

- 1. The request will only be considered provided one of the participants to the option structure can clearly isolate the futures traded on the day, or previous day, to cover the delta to the option strategy*
- 2. The futures level traded and reported will be used as the basis to value the reported option trade*
- 3. The DOT may involve multiple option strikes*
- 4. There is no minimum volume requirement for a DOT trade*
- 5. DOT trades that are processed by the JSE and not matched via the central order book will not be considered for daily mtm volatility purposes*
- 6. The JSE will process the request, no members may process this themselves*
- 7. Both counterparties to the DOT will be required to submit the request via the prescribed template ([http://www.jse.co.za/Libraries/SAFEX_AP - Trading_Information - Report_only_Trade_Template/Report_Only_Template.sflb.ashx](http://www.jse.co.za/Libraries/SAFEX_AP_-_Trading_Information_-_Report_only_Trade_Template/Report_Only_Template.sflb.ashx)) by the latest 30 minutes after the close of trade (12h30 in the case of physically settled grain options)*
- 8. DOT trades must be reported to the Division by email (commodities@jse.co.za) – a confirmation note will be issued by the JSE acknowledging that the DOT was received, all information specific to the reported trade will be published to the market via the trading front end.*

The Exchange reserves the right to remove the above trade type at any time without prior notice.

2. Structured Options Trade (SOT)

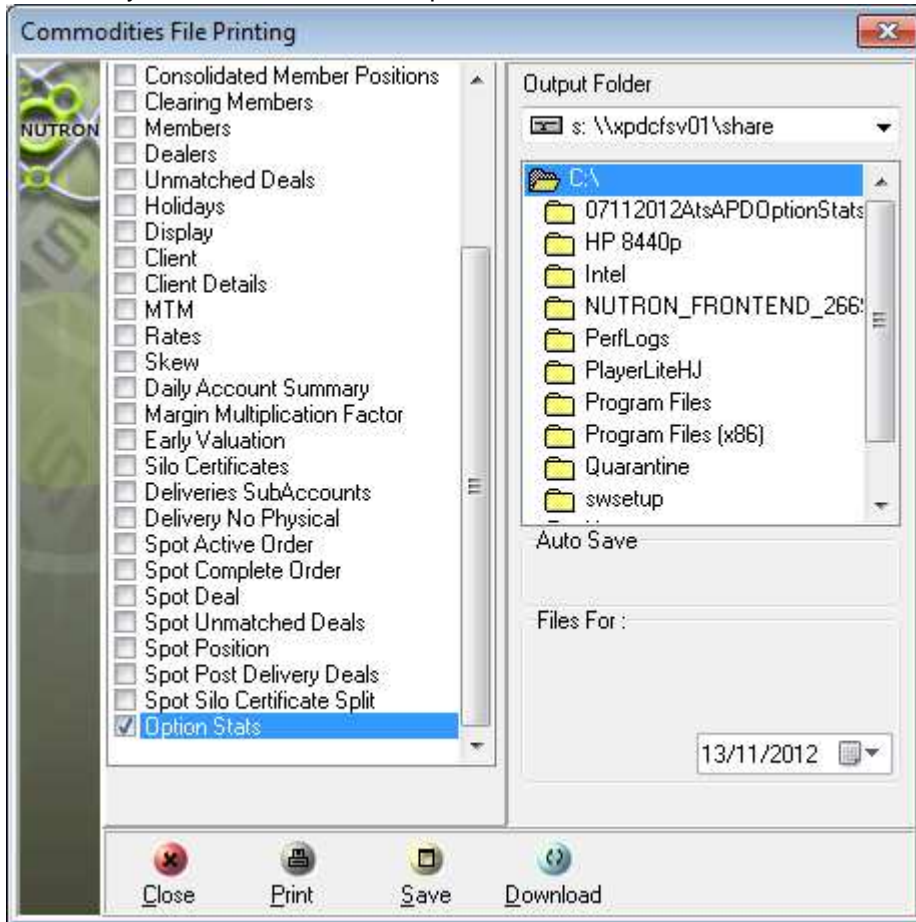
To accommodate structured option trades which include two or more strikes and which are agreed on a wholesale basis, these may be reported in the required format provided the following criteria is met:

- 1. The request must involve multiple option strikes within the SOT*
- 2. A minimum of **25 contracts per strike** will be required*
- 3. SOT trades that are processed by the JSE and not matched via the central order book will not be considered for daily mtm volatility purposes*
- 4. The JSE will process the request and publish all matching information including volatility to the market*
- 5. Both counterparties to the SOT will be required to submit the request via the prescribed template [http://www.jse.co.za/Libraries/SAFEX_AP - Trading_Information - Report_only_Trade_Template/Report_Only_Template.sflb.ashx](http://www.jse.co.za/Libraries/SAFEX_AP_-_Trading_Information_-_Report_only_Trade_Template/Report_Only_Template.sflb.ashx) by the latest 30 minutes after the close of trade (12h30 in the case of physically settled grain options)*
- 6. SOT trades must be reported to the Division by email (commodities@jse.co.za) – a confirmation note will be issued by the JSE acknowledging that the SOT was received*

The Exchange reserves the right to remove the above trade type at any time without prior notice.

The above trade type information is also available of the JSE website for future reference and is effective immediately: <http://www.jse.co.za/Markets/Commodity-Derivatives-Market/Commodity-Derivatives-trading-informationandtypes.aspx>

Members are also reminded of the functionality available via the API or NUTRON whereby users can download each and every option traded for the day, this includes the option volatility at which the trade was matched. Below a snap shot of the screen available via NUTRON after selecting "Print/Transfer", then "Print" followed by "commodities", select "option stats":



Please feel free to contact the commodities team if there are any questions regarding the published notice.

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