Market Notice

Number:	A1732
Date	4 December 2012

Implementation of the updated futures mark-to-market methodology recognising the calendar spread relationships of products including changes to the option mark-to-market methodology and report only requirements for options

Following a submission to the Agricultural Advisory Committee in October, it was agreed to run a trial on a newly proposed futures mark-to-market (MTM) methodology for one month and gauge if the market is comfortable with the new approach. The process was also detailed in market notice A1705. The exercise was conducted from 01-30 November where the JSE was publishing comparative daily MTM figures to the market via email.

Features of the proposed new approach are as follows:

a) As before, snap shots were taken every minute for the last 5 minutes before 12h00 of every trading day. A random sample was chosen to determine the m-t-m price for the day for each of the listed contracts.

b) In addition to the above, Volume Weighted Average Price (VWAP) was also considered. A contract is said to be liquid on a particular trading day if 50 or more contracts were traded during the final 15 minutes of trading session. The contract will be considered illiquid otherwise. Please take note that the old arrangement was to consider 100 or more contracts traded during the last 30 minutes of trading session.

c) If there is more than one contract expiry for a particular commodity that meets the VWAP qualification criteria, only the most liquid will be referenced for m-t-m processing.

d) We then determine the spread difference between the m-t-m prices across all expires for a product based on the sample that was randomly selected. Once this is determined then the selected VWAP value becomes the reference from which all the other expiries are adjusted by the spread difference. This is done in order to maintain the same spread relationship amongst the contract expiries before and after VWAP is implemented.

Our observation over the last 30 days was that closing prices under the new methodology achieved the objective set out. Further, no complaints were lodged by the market against the new MTM approach with positive comments received.

It is for this reason that the JSE will officially replace the futures MTM methodology across all commodities with the updated one effective **Monday, 10 December 2012**. The updated futures MTM process will be recorded as follows:

- *MTM for the day, which is also referred to as the settlement price, will rely on a random sample selected any time in the last 5 minutes of trading at the discretion of the exchange.*
- *Based on the random snapshot selected, the MTM price is a function of referencing the last traded price* ***unless*** *there is a better bid or lower offer. If the closing bid is above the last traded price this will then be used MTM, alternatively if the offer is lower than the last traded price then the offer will be used as the MTM.*

- *Following this the spread relationship per product is determined across all expiries based on the sample set that was randomly selected.*
- *Then to recognize the liquid expiries within the MTM process, the most liquid expiry per product meeting the Volume Weighted Average Price (VWAP) criteria is selected as the reference from which all other expiries are adjusted by the spread difference, the following applies:*
    - *An expiry will be considered liquid on the trading day for the purpose of determining the MTM if **<u>50 or more</u>** contracts trade during the last 15 minutes of a trading session*
    - *Should multiple expiries per product meet this criteria, only the most liquid will be selected as the reference expiry month*
    - *Only on screen traded activity will be taken into account when determining the VWAP*
    - *Please note the VWAP will not be taken into consideration on the day should the following occur:*
        1. *where the market is bid limit up or offered limit down in the last 10 minutes with limited or no trade taking place. In this case the MTM will remain at the price limit level.*
        2. *when the VWAP has resulted in the MTM outside the daily price limits due to spread trades. In this case the MTM will remain at the price limit level.*

- *Once the reference VWAP value is determined, it becomes the reference price from which all the other expiries are adjusted by the spread difference. This is done in order to maintain the same spread relationship amongst the contract expiries before and after the VWAP is recognized.*
- *In the event that no product has any expiries meeting the VWAP criteria, the random snapshot as selected will prevail without any further adjustments.*

Further to market notice A1717 published on the 13th November 2012, no objections were received to the proposed changes and so the below will be implemented at the same time as the updated futures MTM process:

- *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 <u>selected</u> 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 <u>selected</u> 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.*

In addition to this, please also note that Delta Option Trades (DOT) and Structured Option Trades (SOT) will only be accepted up until 30 minutes <u>before</u> the close of trade (11h30 in the case of physically settled grain options) and NOT 12h30 as previously published.

The JSE web page will be updated with the latest methodology including the changes to the DOT and SOT reporting requirements.

We are confident this updated methodology will continue to strengthen the end of day market processes and evolution of the commodities market. Should there be any queries regarding the updated futures MTM methodology, please contact the Commodities Team on 011 520 7535 or e-mail commodities@jse.co.za .

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