



A new landmark in trading

JSE

DERIVATIVES MARKET

Equity Derivatives

Dividend Futures

www.jse.co.za



Johannesburg
Stock Exchange

The JSE in collaboration with Deutsche Bank and Investec Capital Markets is launching an exciting initiative allowing investors to purchase cash settled futures on foreign listed equities. International Derivatives will be traded on the existing Equity Derivatives Market trading platform.

The JSE's International Derivatives is an initiative in collaboration with Deutsche Bank and Investec Capital Markets that will provide South African investors (including corporate investors, trusts and funds) with an opportunity to trade and gain exposure to the price movements of internationally listed equities (shares) and potentially internationally recognised indices.

The JSE's Equity Derivatives Market will list, provide a trading platform, regulate, risk manage and clear cash settled equity derivatives (initially futures and at a later stage options) on internationally listed shares (e.g. BP, Vodafone, Glaxo Smith Kline, Rio Tinto and Nokia) that are not listed on the JSE.

This exciting initiative will allow local investors simple and effective access to international markets, without exchange control restrictions¹ or the counterparty risk associated with unregulated over-the-counter trading.

Overview of Single Stock Futures

Single Stock Futures (SSFs) have taken the world by storm and the JSE was recently ranked number one in the world in terms of volume (number of contracts traded).

SSFs are futures contracts on individually listed shares. A futures contract is a legally binding agreement that gives the investor the right to buy or sell an underlying listed share at a fixed price on a future date.

SSFs are traded on an exchange, in South Africa's case, the JSE. They are standardised contracts with set specifications regarding size, expiry dates and tick movement (the minimum upward or downward movement in the price of a security).



Investors are required to pay an initial margin ('good faith' deposit) upfront when trading in SSFs. Interest is earned daily on this margin which is held by the exchange. When positions are closed the initial margin plus interest is paid back.

The value of an SSF contract is equal to the underlying share's futures price. For example, if company A is trading at R20 then holding one futures contract is equivalent to investing R20 in that company. However, the investor is only required to pay an initial margin of R2 (approximately 10% – 15% of the value of the underlying shares). Due to this gearing, SSFs provide exposure to the underlying share at a much lower cost than trading in the underlying share.

A contract holder can exit a futures contract before the expiry date (this is called closing your position) or keep the contract until the expiration date.

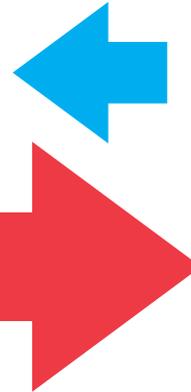
1 Refer to Appendix A Exchange Control Regulations

Who uses Single Stock Futures?

Derivatives have two main users: hedgers and speculators.

Hedgers seek to reduce risk by protecting an existing share portfolio against possible adverse price movements in the physical (or spot) market. Hedgers have a real interest in the underlying shares and use futures as a means of preserving their performance.

Speculators use SSFs in the hope of making a profit on short-term movements in the futures contract price. They often buy and sell derivatives contracts in their own right without transacting in the underlying share. Speculators may have no interest in the underlying shares other than taking a view on the future direction of its price.



Trading in International Derivatives

Opening an account

Like all securities listed on the JSE you have to trade through a JSE member (broker). For a full list of members please visit www.jse.co.za. Alternatively you can contact the JSE's derivatives trading division on 011 520 7000 or derivativestrading@jse.co.za.

International Derivatives are traded on the same equity derivative platform as all other equity derivative products. If you are already registered to trade on the JSE's Equity Derivatives Market you will also be able to trade International Derivatives through your broker.

Trading Positions

When trading in futures contracts there are two positions that an investor can take:

- ▶ Long Position – Go Long – Buy Future
- ▶ Short Position – Go Short – Sell Future

When you 'go long' you are buying exposure to the underlying share because you believe the price of the underlying share will increase. If it does so by the time the contract expires (or before the contract expires), you will be able to sell or 'close' your position, thereby realising a profit.

You will 'go short' if you believe the price of the underlying share will decrease, thereby realising a profit if the futures price goes down over the life of the contract.



Margining

International Derivatives will follow the same margining process used in the Equity Derivatives Market. There are two types of margins: initial margin and variation margin.

▶ Initial margin

When a position is opened (either long or short), the investor is called on to pay an initial margin. The initial margin is approximately 10% – 15% of the value of the underlying share, this is an estimate of the maximum amount that can be lost in one day. This amount remains on deposit as long as the investor has an open position. It attracts a market related interest rate, which is refunded to the investor once the position is closed out, or the contract expires. The initial margin protects investors from counterparty risk (the risk associated with one of the initial parties defaulting).

Example

A deal was concluded whereby a client of Broker ABC bought an International Derivative Single Stock Future contract to the value of R1700. Broker ABC would also have arranged a seller of one contract at this price. The JSE would require an initial margin deposit of approximately R170 from both buyer and seller of the contract.

▶ Variation margin

This can be seen as your daily profit or loss.

At the end of each trading day, contracts are Markedto-Model (M-t-M). The exchange independently calculates a fair value (or closing price) for each contract. The difference between your traded price, if traded on the day, and the previous day's M-t-M, if this is a brought forward position, is calculated as profit or loss, payable to the clearing house via the clearing member. This payment is called variation margin.

Example

	Date	Closing Price M-t-M	Change	Seller		Cash flow	Buyer	
				Payment	Balance		Payment	Balance
Initial Margin	Day 1	1,700.00		170.00	170.00		170.00	170.00
Variation Margin	Day 2	1,720.00	20.00	20.00	170.00	20.00 >		190.00
Variation Margin	Day 3	1,650.00	70.00		240.00	70.00 <	50.00	170.00
Variation Margin	Day 4	1,770.00	120.00	50.00	170.00	120.00 >		290.00
Margin Account Settled	Day 4			170.00	nil		290.00	nil
Net Cash flow	Day 4		70.00	70.00			70.00	

In our variation margin example on page 2, during its term, there are only three different M-t-M prices for a Company X International Derivatives SSF (expiring on Day 4). The table above shows the treatment of both the buyer's and the seller's margin accounts held (interest on margin accounts, booking and clearing fees have been ignored for this exercise):

On Day 1 a client of Broker ABC buys one International Derivatives SSF contract on Company X for R1700. On Day 2 the exchange establishes the closing price for that future to be R1720. This is deemed to be the M-t-M price for Day 2. The price movement represents a positive movement of R20 for the buyer of the International Derivatives SSF contract, resulting in a R20 profit (R20 x 1 contract).

Conversely, this represents a negative movement of R20 for the seller of the International Derivatives SSF contract. The exchange will require that the seller pay R20 into his variation margin account which will then be paid into the buyer's variation margin account.

The margin required to be paid by the buyer on Day 3 is R70 (representing the R70 price movement from the previous close). The buyer has R190 in his margin account, but only R20 of this could be used to meet the margin payment in order to maintain a balance of R170. The buyer is therefore called on to pay an extra R50 (R70 minus R20).

The margin required to be paid by the seller on Day 4 is R120 (representing the R120 price movement from the previous close). The seller has R240 in his margin account, but only R70 of this could be used to meet the margin payment in order to maintain a balance of R170. The seller is therefore called on to pay an extra R50 (R120 minus R70).

The example shows how necessary it is for each investor to maintain a minimum balance in their margin account – representing their initial margin (in this case R170). When the credit balance is insufficient to meet a margin payment (and still maintain a minimum balance of R170) an additional payment by the investor is required.

Notice how, during the contract period, the futures price moved a total of R70 higher. This represented a total profit to the buyer of R70.00 and a total loss to the seller of R70. The margining system is effective in ensuring that both buyer and seller are constantly up-to-date in their profits and losses and not subjected to a potentially massive settlement of their losses upon expiry of the contract.

Through the variation margin process the status of each position is managed so that each investor is aware, on a daily basis, of their cash flow commitments on an open position. In this regard, the investor must be confident that they have the resources to maintain the position for the intended period.

Failure to honour a variation margin call within the prescribed time (i.e. by 12h00 on the following business day) will result in the position being closed out immediately by the broker. To mitigate this risk, many brokers require a deposit to be paid to them in advance.

Upon expiry of an International Derivatives SSF contract or the closing of a position, the economic effect of all cash flows representing margin payments or receipts must reflect the total profit or loss to the holder of a contract. Each investor's initial margin (with interest) is repaid together with any surplus margin balance (where applicable).

Closing a position

An International Derivatives SSF contract holder has two options, either wait until expiry or arrange with his/her broker to close the position before expiry. The official close out price (expiry price) will be determined by the JSE on the expiry date of the contract. The holder also has the option to roll (close current contract and open a new contract for a future expiry date) his/her position on expiry to the next expiry date.

Expiry dates are contract specific, however the JSE recommends that they are aligned with the currency derivatives market.

Corporate Actions

The JSE will attempt to replicate the underlying Exchange's (as set out in the contract specifications) treatment of corporate actions (Mergers, Special Dividends, Stock Splits, Divestitures etc).

International Derivatives Dividend Futures

When a company pays a dividend its share price usually declines by a corresponding amount. The reason for this price decline is that part of the company's available capital has now been paid back to shareholders.

When you buy an International Derivatives SSF the exchange has already estimated the dividends that will be paid prior to expiry and removed them from the price. You can limit this estimation risk (the risk associated with an incorrect calculation by the exchange or liquidity provider) by buying a dividend future along with your International Derivatives SSF.

Some Liquidity Providers will require you to purchase a dividend future when purchasing an International Derivatives SSF. This helps to ensure that neither party loses out on the transaction due to incorrect dividend estimations.

Clearing and Guarantee

All trades on the JSE's Equity Derivatives Market are M-t-M, margined daily and guaranteed by the clearing house.

Due to the clearing house guarantee and our regulatory framework, investing on the JSE exposes the investor to less counterparty risk than investing in over-the-counter products. The clearing house guarantee and the daily margining process ensures that investors' margins are safer from the risk of a defaulting counterparty.

Benefits of International Single Stock Futures

► Diversify offshore

Investing internationally is an important part of building a diversified investment portfolio. By investing in International Derivatives SSFs investors can not only share in the growth of the world's largest and profitable companies but also reduce overall investment risk;

► Convenience

International Derivatives SSFs provides a convenient entry point into foreign markets without the restrictions and paperwork of exchange control regulations or the expense of setting up a foreign trading account. When investing directly into a foreign market there are complicated securities laws, levies and taxes. If you go through a third party manager there are additional costly fees. The JSE's International Derivatives initiative eliminates all these obstacles.



▶ **Invest offshore without using or minimising your Offshore Allowance**

As an individual or corporate entity investing in International Derivatives does not use any of your offshore investment allowance. As a registered asset manager, International Derivatives products do not require Reserve Bank permissions but they do fall under your prudential foreign portfolio limits. The International Derivatives liquidity providers will be responsible for buying the underlying shares. The JSE will then issue an International Derivatives SSF contract on the underlying asset enabling investors to get foreign exposure effectively and easily through a local broker.

Additional Benefits of International Single Stock Futures

- ▶ SSFs offer you an opportunity to protect/hedge your share portfolio by selling SSFs in the same underlying share.
- ▶ SSFs incur lower brokerage costs than actually trading in the underlying shares.
- ▶ Your initial margin earns interest for the duration of your contract.
- ▶ Corporate actions affecting the underlying shares are taken into account on the futures contract.
- ▶ SSFs are characteristically liquid and easily traded.
- ▶ With margin requirements of approximately 10% – 15%, SSFs provide a highly capital efficient way to participate in shares.
- ▶ The JSE independently calculates the closing price on all listed SSFs.
- ▶ You can sell short futures, benefiting from a downward price movement.

Risks

- ▶ Gearing offers significant returns but can also result in significant losses if the market moves against your position. Only experienced investors or investors with the help and advice of an experienced adviser should participate in this market. It is important for investors entering this market to be aware of the risks involved.
- ▶ SSFs are not capital protected. Investors may not get back the amount invested.
- ▶ The value of any investment involving exposure to foreign currencies can be affected by exchange rate movements.

Impact of currency fluctuations

As International Derivatives are quoted and traded in South African Rand they have an associated currency risk.

Example

The underlying share of the International Derivatives SSF trades at \$1,000. The Rand/Dollar exchange rate is 1\$ = R10.00. The International Derivatives SSF therefore trades at R10 000.00 (not taking present value and dividend assumptions into account).

Assume the underlying share’s price stays constant at \$1,000 but the R/\$ exchange rate changes from R10.00 a dollar to R12.00 a dollar (Rand weakened against the Dollar). The buyer of the International Derivatives SSF would make money as the value of his future would now be R12 000.00 (\$1,000 X R12 000.00), a gain of R2 000.00. The seller of the international future would have lost R2 000.00 without the price of the underlying share moving.

Currency fluctuation	Impact on International Derivative	
	Buyer	Seller
Rand strengthens against foreign currency	Loses money	Makes money
Rand weakens against foreign currency	Makes money	Loses money



International Derivative contract holders can hedge the associated currency risk with currency derivatives traded on Currency Derivatives. The investor's exposure is then greatly reduced to adverse currency movements and more focused on the underlying share's movement.

For additional information on currency derivatives please contact the Equity Derivatives market on 011 520 7000 or derivativestrading@jse.co.za.

Listing of International Derivatives

The JSE will list international derivatives on request from the market provided that the underlying security to be listed complies with the following requirements:

- ▶ The underlying security must be an internationally listed security.
- ▶ A liquidity provider must be willing to make a market in this security.
- ▶ A reference price must be available on the day of listing and the market price and dividend data must be available daily thereafter.
- ▶ If a request is not supported by a liquidity provider, the JSE will consider a "Can Do" style listing if:
- ▶ There are two counterparties to a pre-arranged transaction; and
- ▶ The minimum value of a trade exceeds 10 million ZAR in value.

Contract specification example	
Product	International Derivative (Single Stock Future)
Underlying Equity	Vodafone Group PLC
Underlying Listed Exchange	London Stock Exchange (LSE)
Underlying Sector Code	Telecommunications
Part of Underlying Index	FTSE100
Underlying ISIN	GB00B16GWD56
Trading platform Code	VODG
Contract size / Nominal	1 x The underlying equity price in ZAR
Expiry dates and times	16h30; 2 days prior to the third Wednesday of March, June, September and December or the previous business day if a public holiday.
Quotations	Price per underlying equity to two decimals in ZAR.
Minimum Price Movement	0.01 ZAR
Expiry Valuation Method	The official close out price determined by the JSE will be used.
Settlement Method	Cash settled
Trading Hours	08h30 – 17h30
JSE Fees	2 Basis points of nominal value
Daily M-t-M closing price	The official daily closing price will be determined by the JSE between 17h00 and 17h15.

Appendix A: Exchange Control Regulations

International Derivatives Dispensations

Since the Budget Speech of 2008 all corporate entities including limited or unlimited companies, private and public companies, closed corporations, partnerships, trusts, hedge funds and banks are authorised to trade currency futures with no restrictions on the value traded. Corporate entities do not need to apply to the Reserve Bank for approval to trade the currency futures nor do they have to report their trades. International Derivatives fall under this same dispensation from the South African Reserve Bank. See Exchange Control Circular 10/2007 "Inward Listing of Derivatives with Foreign Reference Assets".

International Derivatives Qualifying Clients

The following categories of clients are permitted to trade and hold positions in International Derivatives and are referred to as "qualifying clients."

- ▶ A South African individual with no limits applicable.
- ▶ A South African corporate entity with no limits applicable.
- ▶ A non resident individual or non resident corporate entity with no limits applicable.
- ▶ A resident financial service provider and Collective Investment Scheme subject to their foreign portfolio allowance.
- ▶ A resident pension fund subject to their foreign portfolio allowance.
- ▶ A resident long-term or short-term insurer subject to their foreign portfolio allowance.

For additional information contact:

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Compiled: April 2014.