

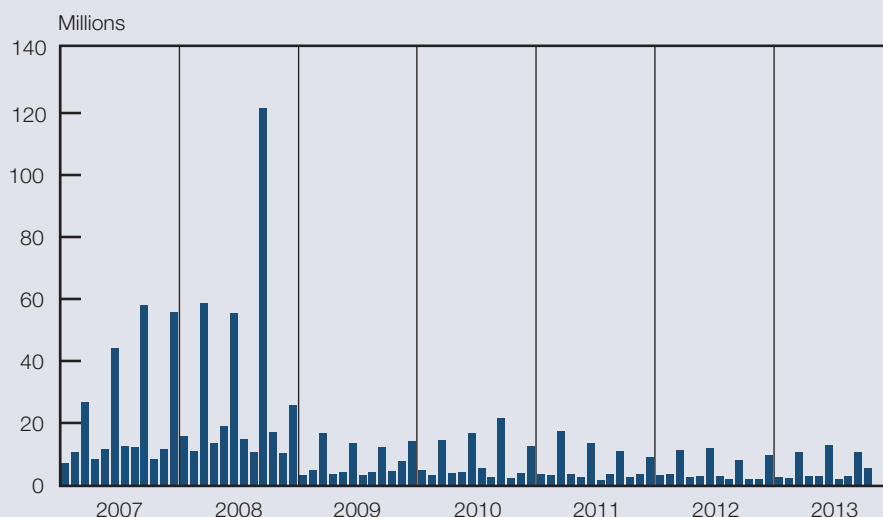
Box 4: Trade in single stock futures and contracts for difference on the Equity Derivatives Market of the JSE

In the field of finance, a derivative instrument derives its value from the performance of underlying financial instruments such as shares, bonds, currencies, commodities, indices and interest rates. Early types of these contracts can be traced back to biblical times. However, it was not until the late 1630s that in some settings these contracts started to be formalised and standardised, for example through the forward contracting on Dutch tulip bulbs and the Yodoya rice market futures in Japan. The creation of the Chicago Board of Trade in the late 1840s marked the start of derivative instruments trading as it is known today, although it has undergone many refinements over time.

As can be expected, there are various types of derivative instruments and they have generally grown popular due to, among others, their inherent nature of affording investors leveraged positions, while maximising their exposure to underlying financial instruments. Derivative instruments include a wide variety of contracts, such as structured debt obligations, swaps, futures, options and various combinations of these instruments. In South Africa derivatives trading in a formal exchange setting was introduced in 1987. The continued introduction of new products to this market contributed to higher trading activity on the Equity Derivatives Market of the JSE over time. One of the prominent products is single stock futures (SSFs).

SSFs started trading on the JSE in February 1999. These are exchange-traded derivative instruments that give investors exposure to price movements of underlying individually listed shares. An SSF obligates participants to buy or sell, at a fixed price, a single underlying listed share on a future date. An SSF contract is therefore a legally binding commitment with standardised specifications such as size and expiry date. Soon after their introduction, trading activity in SSFs gained prominence, rising over the years and eventually reaching record-high monthly trading volumes of 121 million futures contracts in September 2008. Subsequently, volumes traded in SSF contracts dwindled following the impact of the financial crisis and as the JSE also tightened its SSF listing requirements post the financial crisis. Higher volumes traded are evident in the final month of each quarter as traders settle their positions during the close-out.

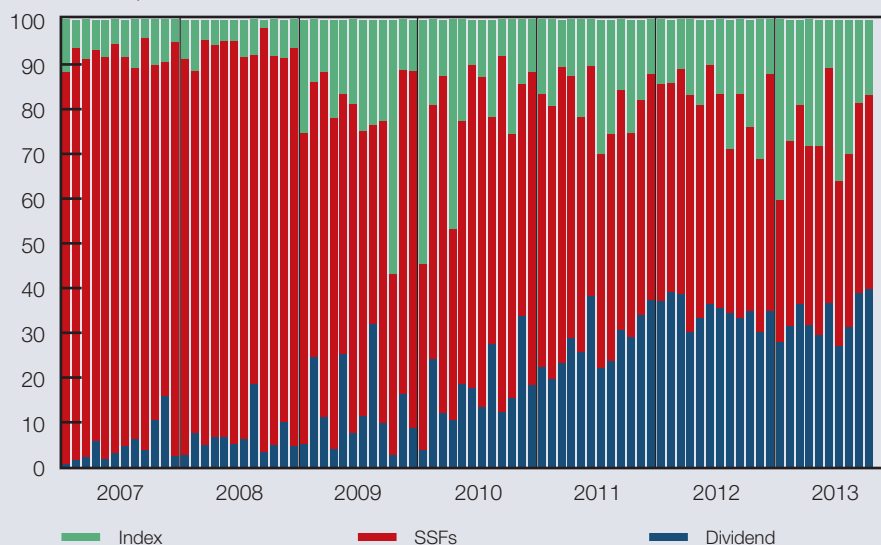
Number of SSF contracts traded on the JSE



In collaboration with an international bank, the JSE introduced international derivatives (IDX) SSFs in November 2008. These are derivatives on international shares that are not listed on the JSE, thus offering investors leveraged exposure to foreign-listed major companies and a useful diversifying tool. Collectively, SSFs continued to dominate trading activity on the JSE's Equity Derivatives Market – accounting for 55 per cent of the total futures contracts traded in 2011 and 49 per cent in 2012. However, in the first ten months of 2013 the contribution of SSFs to the total number of futures contracts traded declined to 44 per cent, as trading in index and dividend futures gained relative importance.

Composition by product type of futures contracts traded

Per cent, based on number of contracts traded



In May 2013 exchange-traded Contract for Difference (eCFD) instruments, with shares as the underlying instrument, were listed on the Equity Derivatives Market of the JSE. A Contract for Difference (CFD) instrument is an agreement (contract) to exchange, at the close of the contract, the difference between the closing and entry value of the underlying share. Trading CFDs involves participants taking positions on the change in value of the underlying asset over time, essentially betting on whether it is going to rise or fall in the future compared to what it was when the contract was taken out. Payment is in favour of the party that successfully predicted the rise or fall in the share price. Trade in eCFDs complements that in SSFs and offers a wider choice of instruments to participants as well as on-exchange trading relative to over-the-counter trading. The listing of the product on the local bourse followed many years of domestic over-the-counter CFD trading. The popularity of this highly leveraged instrument stems from its ability to closely mirror the liquid underlying spot market. Since their launch 28 117 eCFD contracts have traded with a turnover of R3 million. The main attributes of SSFs and CFDs are outlined below.

| Single Stock Futures | Contracts for Difference |
|---|--|
| Costs are standardised and transparent, with a set principal amount and interest priced in and agreed upon beforehand. | The exchange of unknown amounts at the end of the contract suggests price uncertainties. The contract uses floating interest rates, with the Safex Rand Overnight Rate (SAFEY) as the base rate. The notional exposure amount on which the investor pays interest therefore fluctuates daily with the share price. |
| Priced using a forecasted dividend. The investor receives no dividend. The price paid is therefore discounted by the forecasted dividend as compensation. Either party therefore stands to lose, should the forecasted dividend turn out differently at expiry. | Agreements to swap dividends – participants are thus liable for full dividend payments. CFD participants' trading accounts are credited or debited with the cash equivalent to the dividend distributed on the underlying instrument. |
| Can take physical delivery. | Cash settled only. |
| Options allowed. | No options allowed. |