MARKET CONSULTATION

Market Consultation on the treatment of mergers and takeovers in the STOXX indices

Zurich, November 23, 2016
STOXX Limited, a leading provider of innovative, tradable and global index concepts, has decided to conduct a market consultation on the treatment of mergers and takeovers. The market consultation may or may not lead to changes in the index methodology.

PROCESS AND TIMELINE

STOXX invites market participants to submit responses to consultation@stoxx.com. STOXX intends to publish the results of the market consultation, as well as an announcement about potential changes to the index methodology, before January 20, 2017. The consultation is open to all market participants until December 09, 2016. In addition to responses from clients, input from the STOXX Advisory Board will be considered.

CURRENT PROCESS

The current procedure for the treatment of mergers and takeovers is described in the STOXX Calculation guide as follows:

> A merger or takeover is deemed successful, if it has been declared wholly unconditional and has received the approval of all the regulatory agencies with jurisdiction over the transaction.
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> Changes are announced immediately, implemented two trading days later and become effective on the next trading day after implementation.
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> The result of a merger or a takeover is one surviving stock and one or more non-surviving stocks that may not necessarily be de-listed from the respective trading system(s). The rules below are only applied if at least one company in this transaction is a component of the STOXX Benchmark indices. Any surviving stock that does not qualify and the non-surviving stock(s) are deleted immediately.
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> A surviving stock that qualifies for the STOXX Benchmark indices is added to the indices as follows:
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> » STOXX Benchmark indices: The surviving stock replaces the largest of the original stocks.
> » STOXX Size indices: The surviving stock replaces the original stock that belonged to the largest affected Size index.
> » STOXX Blue-Chip and other indices: If one of the original stocks was a component, it is replaced by the surviving stock. Separate buffer rules and additional requirements for individual indices may apply according to specific index methodology.
> […]

MOTIVATION FOR THE MARKET CONSULTATION

The current rule prescribes that a merger or takeover is deemed successful, if it has been declared wholly unconditional and has received the approval of all the regulatory agencies with jurisdiction over the transaction. The rationale of this rule privileges safety and prudence criteria and aims to ensure that the merger or takeover is only reflected in the indices once the deal is certain to happen.

However, the declaration of non-conditionality and the regulatory approval may come at a very late stage of the transaction. Before the transaction is completed, new shares may become available for trading (e.g. the acquiring company issues a new share class for the future company) or investors may have the option to tender shares of the company under takeover for shares of the acquiring company. The companies involved in the transaction may also set an acceptance threshold in terms of shares tendered by shareholders beyond which they would consider the transaction successful.
In these scenarios, the market may effectively anticipate the official conclusion of the merger or takeover as compared to the conditions prescribed by the current index rule. This could be the case if shareholders decide to tender their shares before the declaration of non-conditionality and the regulatory approval is granted.
As a result, the index may not reflect the actual market behaviour. Additionally, the switch to the new shares may be delayed to a time at which liquidity may have reduced, which may also result in increased trading costs.

PROPOSED ALTERNATIVES

To address these scenarios, STOXX intends to consult the market on the alternatives as listed below.

In case that, as part of the merger or acquisition, the acquiring company issues tendered shares and the tendered shares are tradable and fulfil the following criteria:

- are listed on an eligible stock exchange and
- after the merger is complete, shareholders who tendered their shares will receive the shares of the new, merged company

then, the following rule would apply:

Alternative 1: Switch shares in the index as soon as the acceptance criteria declared by the parties involved are met

The merger or takeover is reflected in the index by replacing the old shares with the new shares as soon as the acceptance criteria (e.g. acceptance threshold of tendered shares) stated by the parties involved are met.
In case the merger or takeover fails after the switch has taken place in the index, the pre-transaction situation will be restored in the indices.

This alternative focuses on the alignment with the transaction conditions defined by the parties. However, its application would require a constant monitoring of the acceptance criteria, which may be changed by the parties during the transaction.

Alternative 2: Set a fixed 50% tender threshold to switch shares in the index

The merger or takeover is reflected in the index by replacing the old shares with the new shares as soon as the percentage of tendered shares exceeds 50%.
In case the merger or takeover fails after the switch has taken place in the index, the pre-transaction situation will be restored in the indices.

This alternative, by requiring a simple majority of tendered shares, focuses on the neutrality of the decision. However, the 50% threshold may not be sufficient to meet the acceptance criteria stated by the parties involved. Additionally, passive index trackers would be forced to tender their shares, hence effectively increasing the acceptance of the transaction.

Alternative 3: Set a fixed 75% tender threshold to switch shares in the index

The merger or takeover is reflected in the index by replacing the old shares with the new shares as soon as the percentage of tendered shares exceeds 75%.
In case the merger or takeover fails after the switch has taken place in the index, the pre-transaction situation will be restored in the indices.

This alternative, by requiring a qualified majority of tendered shares, focuses on a stronger market conviction about the transaction. However, the 75% threshold may exceed the acceptance criteria stated by the parties involved. Additionally, passive index trackers would be forced to delay the switch to the new shares to a time when the liquidity of the old shares has diminished.

Alternative 4: Keep current rule

The merger or takeover is reflected in the index once it has been declared wholly unconditional and has received the approval of all the regulatory agencies with jurisdiction over the transaction.

This alternative focuses on the certainty of the transaction and minimizes the risk of rolling back to the pre-transaction situation. However, the market may act in anticipation of the approvals the transaction is subject to and passive index trackers may be forced to delay the switch to the new shares to a time when the liquidity of the old shares has already diminished.

QUESTIONS

A. Do the conditions necessary to deem a merger or takeover successful, as set forth in the current rule, accurately reflect the market conditions and behavior?

B. Does the current rule accurately reflect the timing of the events?

C. Please rank the four alternatives in order of preference (1: most preferred, 4: least preferred):

Alternatives	Rank
Alt. 1: Switch shares in the index as soon as the acceptance criteria declared by the parties involved are met	
Alt. 2: Set a fixed 50% tender threshold to switch shares in the index	
Alt. 3: Set a fixed 75% tender threshold to switch shares in the index	
Alt. 4: Keep current rule	

D. Would you recommend any different treatment of mergers and takeovers than those proposed?

REFERENCES

STOXX Calculation guide
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