

The change of WIG-ESG methodology

Consultation Paper



Warsaw, July 2020

1. CHARACTERISTICS OF THE WIG-ESG INDEX

The WIG-ESG is a total return index and has been published since September 3, 2019. Its purpose is to measure the value of the portfolio of listed companies classified for the WIG20 and mWIG40 indices, verified with the use of an adjustment factor, defined as an assessment of the degree of compliance with environmental, social and corporate governance (ESG - Environmental, Social, Governance) principles. WIG-ESG belongs to the GPW Indices Family.

In accordance with the applicable method described in the GPW Indices Family Rules (**Rules**), the company's share in the index results from the value of free float shares, which is adjusted by the value of the ESG Ratio and the Best Practice Ratio. The value of these ratios result from:

- ESG Ranking, which is created on the basis of the results of ESG data and scorings from the ESG Risk Rating Reports prepared by the independent research agency Sustainalytics B.V. based in the Netherlands. Company can obtain from 0 to 100 points, where it is considered that the lower the number of points awarded, the better the company meets the ESG requirements. Depending on the number of points obtained, the companies in the Ranking are divided into 5 separate quintile groups.
- Ranking of Best Practices is based on the analysis of reports prepared pursuant to § 29 para. 3 of the Stock Exchange Regulations and declarations on the application of corporate governance principles, included in annual companies' reports, and specified in the document called Best Practices of GPW Listed Companies.

2. CHANGE OF METHODOLOGY

GPW Benchmark, as a licensed Administrator, wishes to conduct public consultations of the WIG-ESG methodology. The purpose of the planned change of the methodology is to adjust the revision schedule of the WIG-ESG index to the revision schedule of other indices from GPW Indices Family and to apply the mechanism of adjusting the company's qualifications to quintile groups in the ESG Ranking during index revisions, due to methodology change of ESG Risk Rating Reports.

Currently, in accordance with the Rules, the WIG-ESG is subject to revision once a year after the last session in July, which is applied effectively after the last session in August.

2.1 WIG-ESG index schedule change assumptions

The purpose of WIG-ESG index schedule change is to implement 4 quarter revisions, carried out after the trading session on the third Friday of March, June, September and December respectively.

The proposed change will result also in the implementation of quarter revisions of ESG Ranking (so far it was prepared once a year):

Stage 1 - creating the Initial ESG Ranking

Stage 2 - creating the Final ESG Ranking which is taking into account changes in qualifications to quintile groups

The Best Practice Ranking will still be enumerated once a year after the last session in July.

2.2 New schedule of WIG-ESG index

	I quarter	II quarter	III quarter	IV quarter
Determining the Initial ESG Ranking and qualification of index participants - after the last session of:	January	April	July	October
Determining the Final ESG Ranking and free float shares - after the last session of:	February	May	August	November
Quarter index revision - after the trading session on the third Friday of:	March	June	September	December
Best Practices Ranking - once a year, after the last session of:			July	
Determining the ESG Ranking and the number of free float shares according to the previous schedule after the last session of:	x	x	July (annual revision after last session of August)	x

2.3 The smoothing mechanism for qualification to quintile groups in the ESG Ranking

The implementation of the smoothing mechanism for qualification to quintile group shall apply only in case where the change in the assessment of a given company in the ESG Risk Rating reports results from a change in the ESG data methodology by the supplier of ESG Risk Rating Reports - Sustainalitycs B.V. [hereinafter: **Methodology Change**] which would lead to a re-qualification of the company by more than one quintile group.

When smoothing mechanism is applied, the change in qualification into the new quintile group could not be greater than one within a given quarter revision, while subsequent adjustment of qualification into the higher or lower quintile group due to the applied methodology change would be implemented gradually during subsequent quarterly revisions until the target quintile or alternatively then extreme quintile group is reached. For instance, if change resulting only from Methodology Change led to the qualification of the company to the quintile group higher by 3 groups, the change would be spread over 3 consecutive quarters.

If the change in the classification of a company to quintile group due to a change in the assessment of a given company in terms of being compliant with the ESG requirements [hereinafter: **Assessment Change**] and Methodology Changes occur simultaneously in the given quarter:

- (1) The scale of the impact of the Methodology Change and the Assessment Change is assessed separately;
- (2) After determining the direction and scale of the impact of the Methodology Change and the Assessment Change respectively, the qualification to the quintile group of the company takes place on the basis of balancing the directions and scales of the changes resulting independently from the above; which means that if the qualification under the Methodology Change meant re-qualification of the company to the quintile group higher by 1, while the Assessment Change indicated a decrease by 2 quintile groups, the final qualification of the company in the given quarter would push it down by 1 quintile group;
- (3) The qualification adjustment process described above ends when the company reaches the target quintile group or reaches the 1st or 5th quintile group.

In case of significant changes in the assessment of a given company in the ESG Risk Rating Reports when it is difficult to assess whether the change results from a change in the methodology introduced by Sustainalytics B.V. or the assessment of the company's compliance with the ESG factors, the Administrator shall consult the Stock Exchange Indices Committee or the Oversight Committee of Capital Market Benchmarks in accordance with the GPW Indices Family Rules.

The smoothing mechanism does not apply to the changes of qualification to the quintile group due to the Assessment Change – in such cases it is allowed for the company to re-qualify by more than one quintile group.

3. SIGNIFICANT CHANGE OF THE METHOD

On the basis of the Rules of GPW Indices Family and in accordance with the Procedure of the Cyclical Review of Definitions and Methodologies for Stock Exchange Indices, Methodology Changes for Stock Indices, Consultation Process and "Amendments to the methodologies", the Administrator, taking into account the recommendation of the Oversight Committee of Capital Market Benchmarks, assumed that the concept of 'significant change' of the method refers to any proposed change in each Stock Exchange Index methodology, unless the Oversight Committee of Capital Market Benchmarks concludes, that the proposed change does not constitute a significant change, while taking into account the results of relevant quantitative tests.

Counterfactual tests were carried out while its effects served as necessary yet not sufficient condition to mark an upcoming change as an insignificant one. The tests assume analysis of the following three parameters:

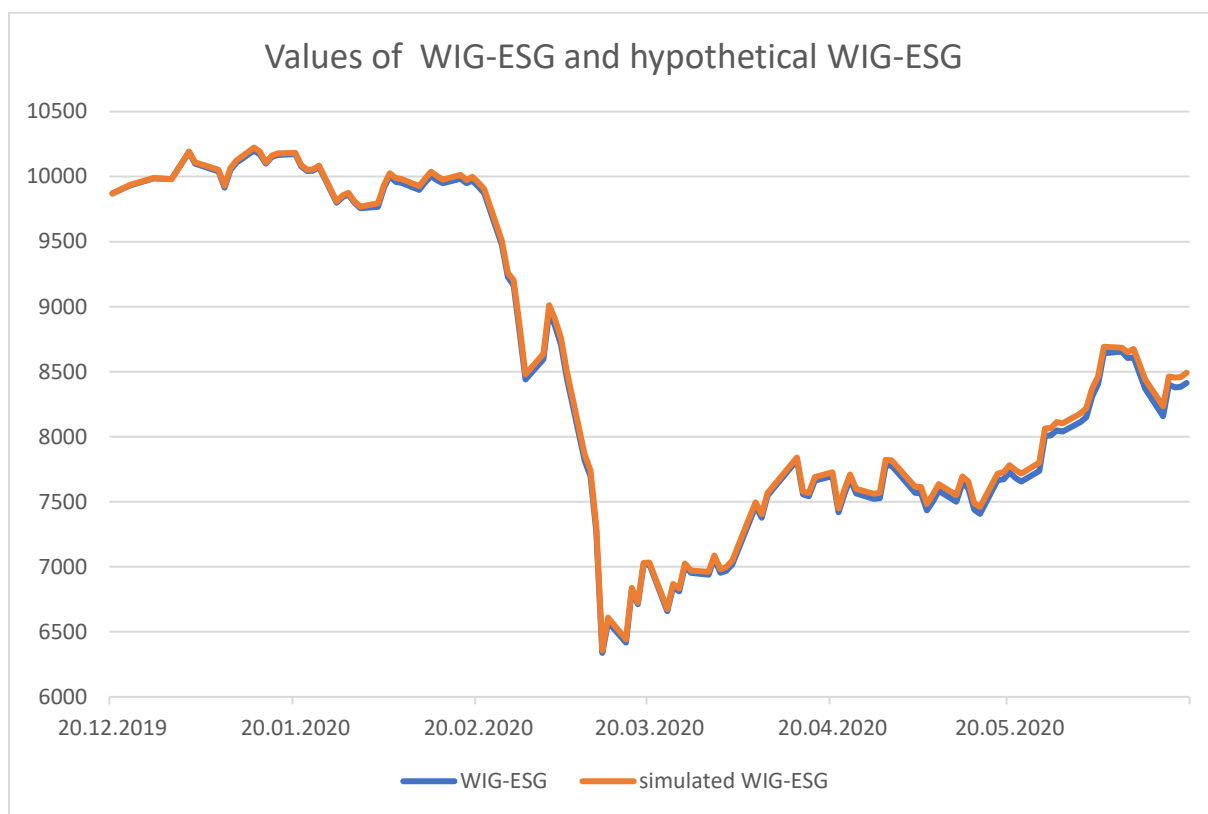
- percentage change of the average daily index change,
- percentage change of the average 20-session volatility,
- changes in the average daily rate in basis points,

considering a change to be insignificant when materiality thresholds accepted by the Oversight Committee not to be violated by all three parameters simultaneously.

The analysis period for the tests covers September 3, 2019 to June 19, 2020. Based on the data from this period, simulations of the hypothetical WIG-ESG index based on the assumptions of the method change were carried out.

The comparison of the actual WIG-ESG index with the hypothetical index showed that only in the case of the percentage change of the average 20-session volatility, the significance threshold was not exceeded. In the remaining cases, there thresholds were breached, therefore the test results indicate that the change should not be marked as an insignificant change.

The chart below shows the values of both the hypothetical WIG-ESG and the WIG-ESG values:



The results of the analysis were presented to Oversight Committee of Capital Market Benchmarks at the regular meeting on June 29, 2020. After an extensive discussion on the matter and while taking under consideration increasing interest in ESG related indices, Oversight Committee agreed and approved that the change of the methodology constitutes a significant change.

Following the Committee's assessment, Administration took a decision to launch a process of public consultations.

4. ASSUMPTIONS OF THE PUBLIC CONSULTATION PROCESS

Professional institutions participating in consultations process of a forthcoming change in WIG-ESG methodology, shall send answers and comments to the questions set out in the questionnaire to the e-mail address indeksy@gpwbenchmark.pl by August 7, 2020.

The administrator will publish the results of the consultation process on the website along with any additional information including the date of the method change.

5. QUESTIONNAIRE

Do you agree with the methodology change resulting in the WIG-ESG revision schedule adjustment to the schedule of the GPW Index Family?

☐ Yes

☐ No

☐ Do not know

Comment

Do you agree with the change of the methodology resulting in the implementation of smoothing mechanism for qualification to quintile groups in case of the change methodology of ESG Risk Rating Reports that would translate in to the change of the quintile groups by more than 1 in a given quarter (i.e. the qualification to the new quintile group stemming from the methodological change could not be greater than +/- one group within a given quarterly revision)?

☐ Yes

☐ No

☐ Do not know

Comment