

Summary of public consultation concerning the revision of the development methods of WIG20, mWIG40, sWIG80 and WIG30 Indices

Based on the closed public consultation on the change of methods of development of the WIG20, mWIG40, sWIG80 and WIG30 GPW Indices, GPW Benchmark S.A. (the „Administrator”) provides a summary of responses provided by stakeholders¹.

The consultation document was presented to the public on 7 December 2020. The deadline for responses was 8 January 2021. This was the second consultation concerning changes to the methods of GPW Indices. This time, the consultations concerned the WIG20, mWIG40, sWIG80 and WIG30 Indices, i.e. the Indices involving the companies with the largest capitalization and the highest turnover on the GPW Main Market. The Administrator received nine responses overall.

1. OUTCOME OF THE CONSULTATION

Question 1: Are you in favour of the change of the methodology introducing the monthly turnover ratio (MTR) as an additional selection criterion for WIG20, mWIG40, sWIG80, and WIG30?

Responses:

	number
Yes	7
No	2
no opinion	0

Summary of comments

Regarding question 1, the Administrator received seven responses supporting the need to introduce a turnover ratio (MTR) as an additional selection criterion. Among the comments received, the following are noticeable:

- *The introduction of MTR should support changes in portfolios of indices "net" of companies with low liquidity or liquidity „disrupted” by singular, high-value transactions.*
- *The introduction of the MTR ratio will help avoid cases where there were companies with negligible turnover in the indices – despite meeting the minimum size of shares in fre- float. This will preserve the "investability" function of the index.*

¹ Document available at:

https://gpwbenchmark.pl/pub/BENCHMARK/files/PDF/komunikaty_indeksowe/Consultation_Paper.pdf

- *One might consider introduction of verification of MTR ratio at least twice a year for Indices*
- *In addition, taking into account the experience from 2020 in connection with changes in WIG20 composition, I would consider introducing an additional criterion in the regulations, allowing a company only to be included on the reserve list for WIG20 (for reputational reasons, among others), if a given issuer has met the criteria for promotion to the index for at least the last four quarters, or at least in the absence of contraindications from 'advisory bodies', e.g. the Committee of GPW Index Committee. Such a solution would aim to increase transparency of the rules for trading participants, translating into greater market efficiency.*

Critical comments on the introduction of the turnover ratio (MTR) were putting forward the following arguments:

- *The simulations presented in the consultation document indicate that adding the MTR ratio will not result significantly in the qualification of companies to the index portfolio. An additional ratio will lead to complications in the process of transparency of indices.*
- *The turnover ratio is relatively easy to manipulate, for example when exchanging large shareholdings. It should relate to the entire capitalisation of the company and not to the free float, which is easily manipulated through reporting and is to a certain degree subject to subjective assessment.*
- *Rather, a session-weighted average spread should be introduced into the methodology according to the FESE/ GPW methodology and aggregated using a median. This measure is more stable than the turnover/ turnover ratio and also reflects the transaction cost of on-exchange trading.*

The Administrator refers to the critical comments and alternative proposal in point 2 (below).

Question 2: What is your opinion about the change of the methodology introducing new weights used in scoring to reinforce the role of company capitalisation in the ranking bearing in mind the proposed implementation of the turnover ratio as a criterion for qualifying companies to indexes?

Responses:

	number *
keep Option 1 (currently applicable)	3
Introduce Option 2 (new proposal)	5
no opinion	0

**one of the stakeholders did not answer the question*

Summary of comments

Attention is drawn to the following positive comments, supportive of introduction of new weightings for setting ranking points:

- *In turn, it should help to qualify companies for indexes with appropriate capitalization, which will also have an impact on the better composition of*

component weights in the index (fewer companies with a trace share), less polarisation of companies.

- *The new option should allow larger companies to move faster to „larger” indices. Often sWIG80/mWIG40 indices consisted of companies on which, in a short period of time, increased „artificial” turnover took place - created mainly by individual investors.*
- *The implementation of the turnover ratio ensures, to a large extent, that companies with sufficient liquidity are included in the indices. Due to this and the fact that the final share of the company in the index depends, and so only on its free float capitalisation, shifting the weights in favour of the capitalisation of the companies is a logical solution.*
- *In the case of changes in the qualification of companies to indices (additional turnover criterion), greater emphasis should be placed on capitalisation rankings in order to achieve greater homogeneity of indices in terms of characteristics of companies (in terms of market ratios) and to limit the premium attributed to liquidity that would arise from the introduction of the MTR criterion.*

The critical comments received and the proposed additional solution were as follows:

- *the "strengthening" of capitalisation results in a deterioration of the conditions for arbitration and, consequently, the spread on contracts will be greater and it will be more difficult to manage products based on these indices.*
- *Modification of the rules in Option 2 may result in qualifying for indices of companies with a high value of shares in free float and low liquidity. From the point of view of indices, which are the basis for derivatives, it is important that the companies included in their portfolios are characterized by high liquidity.*
- *In addition, taking into account the experience from 2020 in connection with changes in the composition of WIG20, I would consider introducing an additional criterion in the regulations enabling the company to be included on the reserve list for WIG20 (among others for reputational reasons), if a given issuer meets the criteria for promotion to the index for at least the last four quarters or at least in the absence of contraindications from 'advisory bodies', e.g. KIG. Such a solution would increase the transparency of the rules for trading participants, resulting in greater market efficiency.*

The Administrator refers to critical comments and the additional proposal in point 2 (below).

Question 3: What is your opinion about the change of the methodology introducing new principles of selection of dual-listed companies for mWIG40 and sWIG80?

Responses:

	number
keep Option 1 (currently in force)	0
introduce Option 2 (new proposal)	1
introduce Option 3 (new proposal)	7
no opinion	1

Summary of comments

All comments received concerned the new Option 3 proposal:

- *A more logical option – if the company is capitalization in the upper half of the „superior” index, its participation in the „subordinate” index is unjustified.*
- *Of these options, Option 3 seems to be the most sensible.*
- *Modification of the rules will allow qualification to mWIG40 and sWIG80 indices of foreign companies corresponding to the specificity of these indices.*
- *The proposal to introduce a new rule for the qualification of companies listed in the dual listing in the mWIG40 and sWIG80 indexes, based on the median market value of companies, will allow for a transparent and objective way of eliminating large companies with dual listing from indexes dedicated to smaller companies, while at the same time allowing liquid companies on the Main Market of the WSE to qualify for mWIG40 or sWIG80 indexes.*

One additional proposal was submitted:

- *Due to the fact that these thresholds apply to foreign companies, I would additionally consider taking into account the capitalization of the largest Polish company from a given index (mWIG40 and sWIG80). It may be worth introducing a limit on the basis of the maximum value from the median capitalization of companies from the „higher” index and the capitalization value of the largest Polish company that is eligible for the analyzed index.*

The Administrator refers to the above proposal in point 2 (below).

No negative comments were received regarding the introduction of new principles of selection of dual-listed companies for mWIG40 and sWIG80.

2. CRITICAL COMMENTS AND ALTERNATIVE PROPOSALS

Along with a few critical comments, the Administrator received the following suggestions of alternative solutions². Below a brief explanation is put forward about the reasons why these comments and suggested alternative solutions were not adopted.

Question 1.

The simulations presented in the consultation document indicate that adding the MTR ratio will not significantly result in the qualification of companies to the index portfolio. An additional ratio will lead to complications in the process of transparency of indices.

Whether the addition of the MTR criterion will significantly change the composition of the Index portfolios in the short term should not be considered as a criterion for assessing the proposed solution. The introduction of MTR is intended to safeguard the reliability of these benchmarks in the long term. The aim is to ensure the representativeness and quality of the flagship Indices in accordance with the purpose of their measurement, expressed in the Rules of the GPW Indices Family.

The advantages of this solution will be revealed in specific, individual situations and are aimed at mitigating the risk of qualifying for the flagship indexes of companies, characterized

² Quotes in boxes

by high turnover resulting from individual GPW exchange transactions of above-average value in the period analyzed for the needs of a given ranking.

In the Administrator's opinion, the argument regarding the introduction of a solution reducing the level of transparency of the methods for determining GPW Indexes is not accurate. The transparency of the method results from a precise, clear description of the method of determining the value of the ratio; this value is not related to the „simplicity” or „complexity” of the method. In other words, in the Administrator's assessment, the level of complexity of the method is not correlated with the transparency of the method of developing the ratio; if the elements making up the method are clearly and reliably described in documentation publicly available to users, then transparency is not compromised. The value that the Administrator cares about when implementing these changes is the reliability and reliability of the Indices as benchmarks within the meaning of the Benchmarks Regulation („BMR”).

The Administrator is aware that for non-professional investors, the methods of individual Indices (with the exception of the WIG, containing all companies from the GPW Main Market), in particular the rules for selecting companies for their portfolios, are probably not simple and comprehensible. Nevertheless, the Administrator shall use its best efforts to ensure the highest transparency of the methodology, in particular by:

- i. public disclosure of the full regulatory documentation, including the Benchmark Statement which provides a summary description of the principles governing the determination of the Indices, and the Summary of key terms relating to the GPW Exchange Indices, TBSP.Index and CEEplus³, as well as
- ii. avoiding the application of any discretion in the selection of companies to the Index portfolios, as reflected, inter alia, by introduction of the MTR criterion.

The turnover ratio is relatively easy to manipulate, for example when exchanging large holdings. It should rather relate to the entire capitalisation of the company and not to Free Float, which is easily manipulated through reporting and subject to a degree of subjective assessment.

The administrator sees the merits of this argument. Indeed, the level of free-float can be shaped to a certain extent by the activities of the company or its surroundings. However, the administrator assumes that the analysis of the turnover ratio covering each 12-month period will limit the impact of possible manipulations on the final result. In addition, the method of determining the turnover ratio based on the number of shares in free float is based on solutions implemented by other European administrators, e.g. FTSE Russell. The Administrator is launching an analytical process concerning appropriately selected and calibrated qualitative criteria for the admission of companies to GPW Indices' portfolios. Qualitative criteria should focus on the correct fulfillment of financial reporting obligations by companies. This would be in line with the evolution of standards among other European administrators in this area⁴.

Rather, a session-weighted average spread should be introduced into the methodology

³ all documents available on the Benchmark WSE website: gpwbenchmark.pl under "Documentation" tab

⁴ For example, from Dec. 2020 onwards, only companies that have been profitable for the two most recent years are eligible for admission into the DAX. The requirement to publish quarterly statements and audited annual financial reports is now retained as part of the DAX indices' methodology. More information at: <https://qontigo.com/new-dax-rules-to-strengthen-index/>

according to the FESE/WSE methodology and aggregated using the median. This measure is more stable than the turnover/turnover ratio and also reflects the transaction cost of exchange trading.

In order to analyze this alternative proposal, the Administrator performed weighted average spread simulations - weighted average spread of turnover calculated on the basis of the difference between the buy offers and the sell offers before concluding each transaction, and then weighted by the value of such transaction. Subsequently, the obtained results were compared with the simulation performed using MTR as parametrisation data. It was found that results obtained using the weighted spread were characterized by significantly lower stability of index portfolio than the results obtained with the use of MTR.

Due to the high volatility and span of the proposed parameter, it is very difficult in the opinion of the Administrator to determine any regularity based on which a justified criterion for selection of companies into the Index portfolio, described by an appropriate algorithm, can be determined. For these objective reasons, the proposal will not be taken forward.

Question 2.

the "strengthening" of capitalisation results in deterioration of the conditions for arbitration and, consequently, the spread on contracts will be greater and it will be more difficult to manage products based on these indices.

The overriding value that the Administrator cares for when introducing these changes, is the reliability and credibility of the Indexes as benchmarks within the meaning of the BMR. The comment might be justified, but it is not an argument critical in light of the Administrator's responsibilities.

modification of the rules in Option 2 may result in qualifying for indices of companies with high share-value and low liquidity. From the point of view of indices, which are the underlying for derivatives, it is important that companies in their portfolios are characterized by high liquidity.

It should be emphasized that the Administrator does not give up on high liquidity as a criterion for selecting companies for the Indices; the liquidity criterion will remain an important element of the method of selecting companies for each flagship Index. The introduction of a new borderline criterion in the form of MTR and the simultaneous reduction of the liquidity weight to 40% do not contradict each other, these are complementary actions. The use of MTR will be a criterion for qualifying companies for the Index ranking, which should allow eliminate companies of scant turnover generated by incidental transactions. On the other hand, ranking points will be calculated taking into account the level of free float, to reflect investors' needs in that regard.

When designing the proposed changes, the Administrator also took into account the methodological activities used by other European administrators of the revised data benchmarks, in particular – QONTIGO as the administrator of the DAX benchmark family⁵ and the opinions of its Advisory Committees. The activities of European administrators are

⁵ See: <https://qontigo.com/new-dax-rules-to-strengthen-index/>

shifting towards strengthening the criterion of capitalisation/ profitability as the main factor in the creation of rankings and the qualification of companies for indexes. In the case of the GPW Indices Family, the weight of capitalization increases slightly, without abandoning the liquidity criterion. In addition, a slight reduction in the weight of turnover is complemented by the introduction of an MTR ratio which examines the turnover of individual companies. It should be noted that the aforementioned modification of DAX family methodology assumes a significant limitation of the liquidity criterion in the qualification process to indices (set as a basic precondition at the level of the necessary minimum), in favor of the criterion of the market value of the company as decisive for the aforementioned process.

Question 3.

Due to the fact that these thresholds apply to foreign companies, I would additionally consider taking into account the capitalization of the largest Polish company from a given index (mWIG40 and sWIG80). It may be worth introducing a limit on the basis of the maximum value from the median capitalization of companies from the „higher” index and the capitalization value of the largest Polish company that is eligible for the analyzed index.

To provide an example, author of the proposal pointed out that: at the end of 2020, in the mWIG40 index, ING is the largest company with capitalization of PLN 22.2 billion, while a median of capitalization in WIG20 equal to PLN 17.5 million. In this case, the threshold could be PLN 22,2 billion. Alternatively, it may be reasonable to apply a multiplier for the capitalisation of the largest Polish company of 1.2-1.5, which in this example would constitute the maximum value of capitalisation of a foreign company at the level of PLN 26.6-33.3 billion.

Administrator analyzed the above proposal and could not accept it, due to the highly arbitrary threshold choice. In addition, basing the selection criterion of dual-listed companies on situation of one issuer may, in particular cases, lead to a different effect from the one that the Administrator wants to achieve by introducing the change.

3. DECISIONS REGARDING PRESENTED CHANGES TO THE METHODS

The majority of participants in the consultation process supported the Administrator's proposals for changes to current methods, which involve the introduction of:

- the turnover ratio (MTR) as an additional selection criterion to WIG20, mWIG40, sWIG80 and WIG30 Indices;
- new weights for determining ranking points, „reinforcing” the role of capitalization of companies in the ranking, i.e. weights of 0.4 for turnover and 0.6 for capitalization in free float;
- new qualification rules for mWIG40 and sWIG80 Indices of companies in dual listing.

This summary of the results of the consultation procedure and a recommendation for further action regarding the implementation of significant changes were presented by the Management Board to the Oversight Committee. At its meeting on 10th February, the Oversight Committee recommended to move forward with the proposed changes to the

methods for determining the Indices in question. The opinions and recommendations obtained should be considered as sufficient to introduce the proposed significant changes to the methods of developing the WIG20, mWIG40, sWIG80 and WIG30 Indices, in accordance with the relevant procedure adopted by the Administrator⁶.

The revised Rules of the GPW Indices Family, taking into account the adopted changes in the methods of developing the WIG20, mWIG40, sWIG80 and WIG30 Indices, shall enter into force on March 19th, 2021, i.e. on the periodic adjustment/revision date of the portfolios of GPW Indices, which is scheduled March 19th after the trading session.

⁶ In accordance with point 3.8 of the *Procedure for the periodic review of definitions and methodology for GPW Indices, changes to the methodology for GPW Indices, the consultation process and the suspension and discontinuation of the establishment of GPW Indexes*. This procedure meets the requirements imposed on the Administrator in relation to the "transparency of methodology" referred to in Article 13(1) of the Regulation 2016/1011 of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts („BMR")