

**STOXX LIMITED**

# **MARKET CONSULTATION:**

## **TREATMENT OF STOCK DIVIDENDS AND SPIN-OFFS**

Oct. 13, 2014

# TREATMENT OF STOCK DIVIDENDS AND SPIN-OFFS

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## 1. BACKGROUND AND CURRENT RULES

### 1.1. BACKGROUND

STOXX's index rules on the treatment of various types of stock dividends and spin-offs have been in place for many years without any need for adjustments. As new types and variants of corporate actions in combination with taxation have been announced by companies, market participants have raised questions about the potential implementation of a taxation of corporate actions in the indices and the calculation of dividend points.

With this market consultation, STOXX aims to identify market views and the potential need for clarifications of the index methodology. The consultation covers the treatment of stock dividends and spin-offs in general as described in chapter eight of the STOXX Calculation Guide.

The market consultation may or may not lead to changes in the index methodology effective for 2015.

The consultation will not impact the treatment of the LVMH –Hermes corporate actions expected in Q4 – 2014. The treatment will remain as communicated on Sept. 12, 2014:

*“LVMH announced a stock dividend of another company (Hermes) with a potential taxation. LVMH did not communicate enough details of this event, i.e. how they will implement the taxation. Therefore the final detailed announcement of the index adjustment cannot be made yet.*

*Current practice and the rule book imply the following: The share ratio of stock dividends of another company as communicated by the company will be applied. Should the company communicate two ratios (with and without taxation) then the ratio accounting for the taxation will be used.*

*Dividend points are not generated for stock dividends and spin-offs per chapter 2.1.1 in the STOXX DVP guide.”*

### 1.2. PROCESS AND TIME LINE

STOXX invites market participants to submit responses either via the online survey at <https://www.surveymonkey.com/s/ZFW78KY> or in writing via email to [consultation@stox.com](mailto:consultation@stox.com). The consultation remains open for submissions until Nov. 5, 2014.

Only responses with complete contact information will be considered.

STOXX intends to publish the results of the market consultation, as well as an announcement about potential changes to the index methodology, on or around Dec. 12, 2014. In addition to responses from clients, input from the STOXX Advisory Board will be considered.

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## 1.3. CURRENT RULES

The treatment of taxes, stock dividends and spin-offs are covered in chapter eight of the STOXX Equity Index Calculation Guide (<http://www.stoxx.com/indices/rulebooks.html>):

Withholding taxes are considered where applicable and defined per country. If STOXX becomes aware of an exception on the taxation; e.g. in case a company confirms a deviating tax treatment, the exception will be used for the index calculation.

For the latest update on withholding taxes, please refer to the following link:  
<http://www.stoxx.com/indices/taxes.html>

Shareholders will receive “B” new shares for every “A” share held.

## 5. Stock dividend

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Adjusted price = closing price  $\times A / (A + B)$   
 New number of shares = old number of shares  $\times (A + B) / A$

For price-weighted indices with weighting factors:  
 New weighting factor = old weighting factor  $\cdot x (A + B) / A$

## 6. Stock dividend (from treasury stock)

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Stock dividends from treasury stocks will be adjusted as cash dividends.

a1) If treated as regular cash dividend, only the return indices are adjusted.  
 Adjusted close = close - close  $\times B / (A + B)$

a2) If treated as extraordinary dividend, the price and the return indices are adjusted.  
 Adjusted close = close - close  $\times B / (A + B)$

## 7. Stock dividend of another company

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Adjusted price = (closing price  $\times A$  - price of the other company  $\times B$ ) / A

## 10. Spin-off

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a) Free float market capitalization weighted indices:  
 Adjusted price = (closing price  $\times A$  - price of spin-off shares B) / A

b) Price-weighted indices with weighting factors:  
 Adjusted price = (closing price  $\times A$  - price of spin-off shares B) / A

New weighting factor for the spin-off = weighting factor of the parent company  $\times B/A$

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### Dividend Point Calculations

For clarification, dividend points are not generated for stock dividends and spin-offs per chapter 2.1.1 in the STOXX DVP guide:

The following factors are included in the data calculation:

- the ordinary un-adjusted gross cash dividends (as determined by STOXX methodology) of the individual constituents of the respective STOXX index and;
- withholding taxes of special cash dividends and capital returns as applied to the individual constituents of the respective STOXX index.

A file summarizing all events that generated dividend points in the past is available for licensee on the webpage:

[http://www.stoxx.com/download/data/change\\_files/sx5ed.txt](http://www.stoxx.com/download/data/change_files/sx5ed.txt)

Examples for corporate actions with taxation:

- Carrefour / DIA spin off ex-date July 5, 2011; no dividend points generated
- Kering / Groupe FNAC spin off ex-date June 20, 2013; no dividend points generated
- Eurazeo stock dividend of another company, ex-date May 26, 2011; no dividend points generated

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## 2. SCENARIOS

The scenarios outline how a potential taxation could be introduced by a company, and describe options on how to reflect this in the indices.

### 2.1. Reduced Ratio

A company announces a reduced ratio to reflect the taxation of the distributed shares. The assumption is that the company hands over the shares to the government, or sells the shares on the market for the required tax payment.

Before tax: Shareholders will receive B new shares for every A share held

After tax: Shareholders will receive  $B \times (1 - \text{taxrate})$  new shares for every "A" share held

Example: Assuming a tax rate of 30%, instead of 10 shares being distributed for 10 shares held the ratio would be 7 shares being distributed for 10 shares held considering tax.

The indices (price, net and gross return) would be adjusted in the following way:

Adjusted price = closing price  $\times A / (A + B \times (1 - \text{tax}))$

New number of shares = old number of shares  $\times (A + B \times (1 - \text{tax})) / A$

For clarification, dividend points are not generated for stock dividends per chapter 2.1.1 in the STOXX DVP guide.

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### 2.2. Indirect taxation – application to a dividend

The company distributes a dividend on the same or close to the ex-date of the stock dividend and deducts the taxation of the shares distribution from this dividend.

On the stock dividend shareholders will receive B new shares for every A share held, and the standard treatment as described in chapter 1.3 of this document is applied.

On the dividend the additional taxation will be considered per STOXX calculation guide chapter eight.

*If STOXX becomes aware of an exception on the taxation; e.g. in case a company confirms a deviating tax treatment, the exception will be used for the index calculation.*

### **1. Cash dividend (applies to return indices only)**

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Definition: Cash distributions that are within the scope of the regular dividend policy, or that the company defines as a regular distribution.

Adjusted price (net return) = closing price - dividend announced by the company × (1 – withholding tax)

Adjusted price (gross return) = closing price - dividend announced by the company

For clarification, dividend points are not generated for stock dividends per chapter 2.1.1 in the STOXX DVP guide.

Dividend points will be generated for the gross amount of the dividend only.

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## 3. QUESTIONS TO MARKET PARTICIPANTS

- Should STOXX consider taxes on various corporate actions like stock dividends and spin-offs?
- If taxes are considered for corporate actions should the dividend point calculations reflect this? If yes, how so and why.
- Which advantages and disadvantages do you see if taxes would not be considered?
- Please provide your general thoughts on the scenarios.  
Which scenario do you foresee likely to occur and how do you consider the adjustment of the indices? Do you expect any other scenarios of how a taxation could occur? How could this occur and what would be the appropriate treatment in the indices?
- Should the adjusted price or the number of shares be calculated in a different way? If yes, how so and why?
- Scenario 2.2 *Indirect taxation – application to a dividend* assumes the dividend is sufficient to cover the tax payment for the stock dividend / spin-off. What scenario can you think of if the dividend is not large enough, and how do you think should the index reflect this?
- EUREX does not consider taxes on stock dividends in their single stock derivatives. Are there any impacts from having or not having this consistency between the index adjustments and the single stock derivatives?
- Do you believe there are corporate actions other than stock dividends and spin-offs that should be treated differently? If yes, which ones and how should they be treated?