



Market consultation on potential index methodology change for the Swiss Bond Indices (SBI)

Zurich, 30 April 2018

SIX, the Benchmark Administrator of the Swiss Bond Indices (SBI) has decided to conduct a market consultation on a possible adjustment of the index methodology of the SBI. Based on customer feedback and from the Bond Index Commission, a proposal was developed to change the current procedure for determining the composite rating. Instead of the worst rating of the agencies or institutions, consideration is given to applying the conservative median across all eligible ratings.

Through this broad market consultation, we want to give all market participants and index users the opportunity to analyse and comment on the proposal. Specifically,

- whether and how the new procedure should be implemented and in which timeframe
- whether market participants agree with the feedback that the new procedure would lead to an improvement of the index methodology
- whether a different procedure should be chosen

The market consultation may lead to possible changes to the SBI index methodology in the future. However, these would be communicated separately and with a notice period of at least three months. The market consultation will run until August 31, 2018 and SIX will continuously evaluate the feedback, approach individual market participants if necessary, discuss the results and the next steps in the Bond Index Commission and communicate these afterwards. A summary of the feedback and a corresponding statement by SIX will be made available to all market participants, unless the commentator has requested confidentiality.

All questions and feedback regarding the market consultation can be sent to the following e-mail address: indices@six-swiss-exchange.com

Name	
Role	
Company	
E-Mail	
Phone	
Confidentiality (Yes/No)	



1. Current set of rules for the determination of SBI composite ratings

Currently, a bond will be included in the SBI if it has at least one rating from an international rating agency.

The SBI Domestic uses the ratings of Fedafin and four Swiss banks if no rating from an international agency is available. To be admitted to the SBI Domestic, a bond must have at least one rating from an international agency or two of the above-mentioned Swiss institutions. The SBI composite rating takes into account the worst of the eligible ratings.

Furthermore, the rating of the issuer is used if a bond does not have its own rating. Ratings of a guarantor or a joint security are also taken into account. As indicated above, the worst rating for the SBI composite rating is taken into account.

2. Potential new set of rules for the determination of SBI composite ratings

The future proposal provides for the application of another approach when several ratings are available. With two available ratings, still the worst rating would be used. For an odd number of ratings (3 or 5) the median of the available ratings would be taken into account and for an even number of ratings (4) the next lower rating below the median would be selected (sub-median). This approach ensures, that one of the ratings provided by a rating provider is actually used (rather than an arithmetic average or the like). The following table illustrates the approach:

	1 Rating	2 Ratings	3 Ratings	3 Ratings	4 Ratings	5 Ratings	5 Ratings
Rating provider 1	BBB+	A-	AA-	A-	AA-	A+	BBB-
Rating provider 2		BBB+	A+	BBB+	AA-	A-	BBB-
Rating provider 3			A-	BBB	A+	A-	BBB-
Rating provider 4					A+	A-	BBB-
Rating provider 5						BBB+	BB+
Applied approach (Conservative median)	Worst	Worst	Median rating	Median rating	Rating below median	Median rating	Median rating
SBI composite rating	BBB	BBB	A	BBB	A	A	BBB

International rating agencies still have priority over Swiss institutions and there is still at least one rating of an international agency required, or, in the case of the SBI Domestic segment, two of the Swiss institutions, in order to be admitted to the SBI. The SBI composite rating must be investment grade, but some of the underlying ratings of the agencies or institutions may be non-investment grade.

3. Summary of potential changes for the SBI composite rating

3.1. SBI Domestic Segment

Criterion	Chapter in rulebook	Current rules	Potential new rules
Eligible rating sources	3.1	International agencies: Moody's, Fitch, S&P Swiss institutions: UBS, CS, Vontobel, ZKB, and Fedafin	<unchanged>
Priority in case of guarantor/joint security ratings	3.2	Bond rating, guarantor rating, issuer rating*	<unchanged>
Minimum number of ratings	3.3	International agencies: 1 Swiss institutions: 2	<unchanged>
Priority of eligible rating sources	3.3	If available, ratings of international agencies are used. Only if no such ratings are available, the ratings of Swiss institutions are used.	<unchanged>
Determination of SBI composite rating	3.3 & 3.5	Worst of eligible ratings	Conservative median of eligible ratings (according to chapter 2)

3.2. SBI Foreign Segment

Criterion	Chapter in rulebook	Current rules	Potential new rules
Eligible rating sources	3.1	Only international agencies: Moody's, Fitch, S&P	<unchanged>
Priority in case of guarantor/joint security ratings	3.2	Bond rating, guarantor rating, issuer rating*	<unchanged>
Minimum number of ratings	3.4	1	<unchanged>
Priority of eligible rating sources	-	-	-
Determination of SBI composite rating	3.3 & 3.5	Worst of eligible ratings	Conservative median of eligible ratings (according to chapter 2)

* With certain exceptions, see chapter 3.2 of the SBI rulebook for more details

3.3. Impact and potential scenarios

- The application of the conservative median tends to improve SBI composite ratings. As a result, the average rating of some subindices of the SBI will be slightly improved.
- The number of bonds in the index will increase slightly, as bonds with a mixture of non-investment grade and investment grade ratings might be included in the index.
- If a single agency or institution downgrades a bond to non-investment grade, the application of the conservative median no longer necessarily results in an exclusion from the SBI.
- Statistics figures:

Table 1: Figures for the SBI® and some sub-indices using the current methodology:

	Weight	Number of Bonds	Yield	Duration
SBI AAA	54%	415	0.45%	8.66
SBI AA	22%	429	0.49%	7.17
SBI A	13%	253	0.48%	5.27
SBI BBB	11%	220	0.94%	4.63
SBI AAA-BBB	100%	1317	0.49%	7.45

Source: SIX, own calculations, Data as of 25 April 2018

Table 2: Figures for the SBI® and some sub-indices using the suggested methodology:

	Weight	Number of Bonds	Yield	Duration
SBI AAA	54%	429	0.44%	8.59
SBI AA	23%	438	0.49%	7.14
SBI A	12%	247	0.53%	5.14
SBI BBB	10%	211	0.97%	4.64
SBI AAA-BBB	100%	1325	0.49%	7.43

Source: SIX, own calculations, Data as of 25 April 2018

The tables above show that, at the time of analysis, there are only small changes on an SBI® level. The average rating of the SBI® would be improved marginally, however, the change is too small to show in the letter ratings.



4. Questions

4.1. General questions:

- How do you currently use SIX bond indices (SBI) (e.g. research, advisory, active management, benchmarking, index tracking, index funds)?
- Is the proposal for the use of the conservative median approved?

4.2. Specific questions in relation to the proposal:

- Is the conservative median an appropriate method ? If no, please specify.
- Should the conservative median be applied to the SBI in total? If not, which gradations should be considered (e.g. application only to bonds without ratings of an international agency, application only to SBI Domestic or SBI Foreign)?
- Is it problematic for investors if the SBI includes bonds which show a non-investment grade rating of one of the agencies or institutions ? If yes, please specify.

4.3. Required lead time for potential implementation:

- Is the usual lead time sufficient?
(SIX gives at least three months notice and will make the expected changes in the index composition available to clients in the preview of bond indices)
- Do you require further information to assess the proposal?
- Are there any further suggestions for improving the rules and regulations of the Swiss Bond Indices?

5. References

SBI rulebook

http://six-swiss-exchange.com/downloads/indexinfo/online/bond_indices/sbi_index_rules_en_fut.pdf