REFORM OF THE DAX, THE GERMAN BLUE CHIP STOCK MARKET INDEX

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German Corporate Alert

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Deutsche Börse will expand the DAX to 40 companies in September 2021. At the same time, the MDAX will be reduced from 60 medium-sized companies to 50 companies. Stricter admission criteria will also apply.

In the recent past, the excellent reputation of the German stock index DAX (*Deutscher Aktienindex*) has suffered somewhat, with a lack of corporate governance, high debt, and dwindling profitability of the 30 DAX companies mentioned as the primary causes. In addition, new business models and their disruption effects on traditional businesses are currently not sufficiently considered. The balance sheet scandal at the payment service provider Wirecard helped fuel the public discussion about better control and access rules. After extensive consultations with more than 600 different market participants, German marketplace organizer and transaction service provider Deutsche Börse has now completed its biggest reform since the launch of the DAX in 1988.

In the text that follows, for the purpose of a first overview, we outline the most important results concerning the changes to the index rulebook (Guide to the DAX Equity Indices, version 10.2.8, published on 15 June 2020).

EXPANSION OF THE DAX FROM 30 TO 40

Most striking is the expansion of the DAX from 30 to 40 companies starting in September 2021. The aim of this expansion is to provide an even more comprehensive picture of the largest-listed companies in Germany and, thus, reflect the full spectrum of the German economy. This has been achieved insofar as the DAX will now reflect 94 percent of the value of listed German companies (far more than in Japan, the United States, or France).

For example, the flavor manufacturer Symrise, the laboratory equipment supplier Sartorius, the online retailer Zalando, and the biotech company Qiagen can all hope to be included in the DAX. The Siemens companies Siemens Energy and Siemens Healthineers are also expected to have good chances for promotion.

The much-criticized consequence is that the MDAX, which comprises the companies that rank immediately below (in terms of market capitalization) the 30 DAX-companies, the so-called heart of the German economy, will lose its best driving force and, ultimately, will lose around one-third of its market capitalization. Instead of 60 companies, the MDAX will consist of only 50. It was argued that an MDAX with still 60 companies (then including 10 new companies from the SDAX), would further reduce the average liquidity in the index due to a lower market capitalization of the newly added companies.

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STRICTER ACCESS RULES; INTRODUCTION OF THE PROFITABILITY REQUIREMENT

The most momentous rule is probably that, as of December 2020, all future DAX candidates must have a positive EBITDA (earnings before interest, taxes, depreciation, and amortization) in the last two financial reports before inclusion in the index. The intention of this rule is a fundamental examination of the validity of a company's business model at the time of admission to the DAX. An ongoing review, however, is still not intended. The 2020 rising star Delivery Hero would have failed due to this rule. In Wirecard's case, on the other hand, the rule would have been of no use, as the financial services provider had reported huge annual profits.

STRICTER REPORTING OBLIGATIONS AND FAST EXIT IN CASE OF NONCOMPLIANCE

From March 2021, all members will be required to publish audited annual reports and quarterly notifications. After a 30-day warning period, any violation of these requirements will result in immediate index exclusion.

DECOUPLING OF ADMISSION FROM A LISTING IN PRIME STANDARD (MARKET SEGMENT OF THE FRANKFURT STOCK EXCHANGE WITH HIGHER TRANSPARENCY STANDARDS THAN THOSE REQUIRED BY LAW)

With these additional reporting rules, the essential quality features of the Prime Standard are also included in the index rules, so that, as a result, companies in the DAX are no longer required to be listed in the Prime Standard of the Frankfurt Stock Exchange. Listing on the Regulated Market will be sufficient in future. This change will also be introduced to enable the index provider to react independently and more quickly in the event of a breach of the rules.

AUDIT COMMITTEE (PRÜFUNGSAUSSCHUSS) IN THE SUPERVISORY BOARD MANDATORY

Furthermore, from March 2021, all new DAX members must comply with the recommendations of the German Corporate Governance Code (*Deutscher Corporate Governance Kodex*) in regard to an audit committee on the supervisory board, i.e., there must be an existing audit committee on the supervisory board and this committee must also be staffed. This also applies to a partnership limited by shares (*Kommanditgesellschaft auf Aktien - KGaA*), despite its special structural features. A transitional period will be granted to existing members in order to maintain continuity in the DAX family. They will have to meet the requirement from September 2022.

SCHEDULED MAIN INSPECTIONS TWICE A YEAR

From 2021, the DAX indices will undergo a scheduled main review twice a year (March and September). Currently, such a review is only carried out in September.

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SELECTION OF MEMBERS SOLELY ACCORDING TO MARKET CAPITALIZATION

From the review in September 2021 onward, the market capitalization of the free float alone will be the decisive factor for the rise and fall in the DAX. Stock exchange turnover will no longer be taken into account in the ranking; instead, index members must have a minimum liquidity. The link to market capitalization in conjunction with the new minimum liquidity requirements would implement international standards and ensure sufficient liquidity in the indices.

NO EXCLUSION IN CASE OF PARTICIPATION IN CONTROVERSIAL WEAPONS

An originally discussed plan to ban from the index companies involved in “controversial weapons” was dropped after appropriate consultation. Only a narrow majority of respondents had supported the proposal. The main reason for the rejection was that the sustainability criteria (environmental, social, and governance (ESG) criteria) should be assessed separately from the DAX criteria (and vice versa). This regulation would have affected the aircraft manufacturer Airbus, whose subsidiary maintains launchers for French nuclear weapons.

Overall, the package of measures demonstrates the great flexibility of German regulatory structures to consistently ensure a forward-looking and modern investment environment in Germany.

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