

# iTraxx Roll – Potential Changes

## Crossover number of constituents will increase to 60 names

- **We review potential changes in iTraxx Main and Crossover membership ahead of the upcoming iTraxx roll date (20 March).**
- **Crossover expansion to 60 names** – After requesting feedback from market participants, Markit has confirmed that Crossover will be expanded to 60 names on the upcoming March roll. This will be done using the Supplementary list to select the additional names. Markit will publish updated index rules reflecting this change soon. We expect four names to leave Crossover, one to enter from the “Liquidity List” (i.e. with liquidly traded CDS) and **13 new names from the “Supplementary List”** (i.e. without liquidly traded CDS but with enough debt issued over the past 12 months).
- **We expect seven changes in iTraxx Main and 4 changes in iTraxx Crossover (plus ten additional names due to its expansion)** – see Figure 1.

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Figure 1. Potential changes in iTraxx on-the-run indices

From Series 20 to Series 21. Shaded names from Crossover supplementary list.

OUT Main	IN Main	OUT Crossover	IN Crossover
Adecco	Conti	ONO	Alstom
Alstom	Gecina	PostNL	Play Finance
Deutsche Post	Unibail	ISS	TVN
Linde	Rhodia	Renault	Vougeot Bidco
Henkel	SABMiller		Rexel
Svenska	Cadbury		Astaldi
SES	KABEGR		Altice Finco
			Equiniti
			Thomas Cook
			Takko
			Bulgarian Energy
			Gestamp Funding
			Hellenic Petroleum
			Tereos

Source: Markit, Bloomberg, Citi Research.

- In the first section of this note we review the timeline of events leading to the roll date, the main criteria which will determine inclusion in the new series and the available data on which we are basing our estimates for the potential changes in the composition of the on-the-run indices.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## Roll Timetable and Main Inclusion Criteria

The new (Series 21) iTraxx indices will start trading on 20 March, with the provisional and final membership lists published by Markit in early March respectively, as Figure 2 shows.

Figure 2. Series 20 iTraxx Indices Roll Timetable: Main, Crossover, HiVol and (Senior and Sub) Financials

From	To	Action
6-Sep	28-Feb	Fri. Liquidity: 6m period over which DTCC trading volumes are computed for the purposes of index inclusion.
17-Feb	28-Feb	Fri. Spreads: 10 last business days of February - average spreads over this period are used for Crossover and HiVol inclusion.
	28-Feb	Fri. Ratings: entity ratings as of the last business day of August are considered for index inclusion.
Early March		Provisional membership lists published by Markit.
Mid-March		Final membership lists published by Markit.
	20-Mar	Thur. Roll date: Series 21 iTraxx indices start trading (8:00am London time).

Source: Citi Research, Markit.

Although the most important criteria used to determine inclusion in the new series (spreads, ratings, DTCC trading volumes etc.) will only be available at the end of August (Figure 2), we can already form a view regarding the potential candidates to enter/leave the on-the-run index. To put together this list, we have used the following spreads/ratings/DTCC volumes:

The potential names entering/leaving the indices that we list in this report should be taken as our best estimate only.

We expect that, as spreads/trading volumes/ratings etc. change, the final list may be different.

- **Spreads:** Crossover constituents need to trade above 2x iTraxx Main Non-Financials (average across single names) when the index is formed. We still don't know this level because (i) the spreads considered are the average over the last 10 business days of February and (ii) we don't know the components of the new Main (it is the new Main Non-Financial names – Series 21 in this case – which are considered for this rule). Here, we use spreads as of COB Friday and our expectations for the members of the new iTraxx Main Non-Financials.
- **Ratings** for index inclusion will be considered as of the end of February. Here, we use current ratings.
- **Liquidity:** The liquidity metric considered when determining the components of Main and Crossover is the total DTCC trading volumes from (the week ending on the first Friday of) Sept. 2013 to (the last Friday of) February 2014. Here, we aggregate the weekly trading volumes published by DTCC up to 31<sup>st</sup> February.<sup>1</sup>

There are other important criteria which we also have to take into account when screening for potential names entering/leaving the indices, such as:

- **€100 million debt outstanding** – Crossover constituents need to have at least €100 million of outstanding debt on 13 March<sup>2</sup> (in a currency deliverable into European CDS and with a maximum remaining maturity of 30 years).
- **Ownership and guarantees** – If it is confirmed that one entity has more than 50% of the voting rights of another entity (directly or indirectly), then the most liquid entity qualifies for index membership. If a company is guaranteed by or guarantees another one only the most liquid is eligible.

<sup>1</sup> We note that although DTCC doesn't publish weekly trading volumes for names with low gross outstanding notional (e.g. Schaeffler), these credits will be considered when putting together the final liquidity list which is used for index inclusion. As a consequence, we currently have no trading volume data for several names which could be (and are) part of the indices (Crossover in particular).

<sup>2</sup> Fifth business day preceding the roll date.

## iTraxx Crossover

**iTraxx Crossover** contains **60 European high yield** (or not rated) CDS contracts.

See Figure 5 for a brief summary of Crossover rules – including a description of the two lists from which Crossover members are selected: “**Liquidity List**” and “**Supplementary List**”.

Crossover constituents need to trade above 2x the average spread of iTraxx Main Non-Financials (the new Series 21). This rule is applied to the average spreads over the last 10 business days of February, i.e. 17-28 February. Using the expected changes in iTraxx Main Non-Financials highlighted below, and spreads as of COB Friday, we estimate that the average spread of the credits in Series 21 Main Non-Financials index is 76bp. This means that, to be part of the Series 21 Crossover, credits would have to have an average spread above **152bp**. We expect between two and four names to leave Crossover due to too tight spreads (**ONO** 92bp, **PostNL** 135bp, **ISS** 139bp and **Renault** 149bp – COB Friday). Renault is a very close call as they currently trade very close to the spread cut-off for Crossover. The fewer the names that end up leaving Crossover because of too tight spreads, the fewer the number of names from the Supplementary List which will enter the index (see below).

Figure 3. iTraxx Crossover: Potential credits leaving the on-the-run index

Credits which are part of Series 20 but are at risk of not being included in Series 21. Spreads in bp.

BBG Ticker	Name	iTraxx Sector	EOD 07-Feb 5y spread	27-Jan 07-Feb Av. Spread	Moody's	SP	Fitch	6m DTCC trading vol. (\$m)*	Reason for leaving
ONOFII	Ono Fin li Plc	TMT	92	143	Caa1 STABLE	B-	CCC+	6,000	Too tight
TNTNA	Postnl Nv	Autos & Ind.	135	144	Baa3 NEG	BBB- NEG	NR	5,106	Too tight
ISSDC-Global	Iss Glob A S	Consumers	139	159	NR	B+ POS	NR	1,765	Too tight
RENAUL	Renault	Autos & Ind.	149	161	Ba1 STABLE	BB+ STABLE	BB+ POS	9,613	Too tight

Source: Citi Research, Markit, Bloomberg. \*: Total DTCC trading volumes since 6-Sep-13. \*\* Upfront, assuming a 5% coupon.

### Liquidity List, i.e. with liquidly traded CDS

The Liquidity metric considered when determining the components of Crossover (“Liquidity List”, i.e. with liquidly traded CDS) is the total DTCC trading volumes from September 2013 to (the last Friday of) February 2013. DTCC doesn’t publish weekly trading volumes for some names in the current Crossover Series 20 (e.g. Unilabs, Trionista, Techem and New Look) because they do not have enough gross outstanding notional.<sup>3</sup> However, although the trading volumes for these names are not publicly available, they will be considered by DTCC when putting together the final list of the top-1,000 most liquid names (globally) from which Crossover (and Main) members are selected. We assume that all of the four aforementioned names will be on that final top-1,000 list given that names in Crossover have, historically, traded enough to be part of that list. However, our assumption may well prove wrong, in which case we will have more names from Crossover Series 20 that will not be part of Crossover Series 21.

We can only find one name which satisfies all the rules to enter Crossover via the “Liquidity List”: **Alstom** (which leaves Main due to rating downgrade) – see Figure 4.

### Supplementary list, i.e. without liquidly traded CDS but with enough debt issued over the past 12 months

Given the expansion of Crossover to 60 names, if there are four potential names leaving Crossover and only one entering from the “Liquidity List”, we will be looking at 47 credits eligible for the Crossover “Liquidity List”. As a consequence, **we should have 13 credits entering Crossover from the “Supplementary List”, i.e. without liquidly traded CDS but with enough debt issued over the past 12 months.**

<sup>3</sup> DTCC publishes weekly trading volumes for the 1,000 names with the largest gross outstanding notional (globally). This means that weekly trading volumes for names with low gross outstanding notionals are not published by DTCC, even if they are actively traded.

Based on debt issued since March 2013, the most likely candidates to enter the index from the Supplementary List are (in this order): 1. **Play Finance**, 2. **TVN Finance**, 3. **Vuogeot Bidco**, 4. **Rexel**, 5. **Astaldi**, 6. **Altice**, 7. **Equiniti**, 8. **Thomas Cook**, 9. **Takko**, 10. **Bulgarian Energy Holding**, 11. **Gestamp Funding**, 12. **Hellenic Petroleum Finance**, and 13. **Tereos**. Abengoa is the next one on our list.

Figure 4. iTraxx Crossover: Potential credits entering the on-the-run index

Credits which are not part of Series 20 but are likely to be included in Series 21. Spreads in bp. Shaded names from Crossover supplementary list.

BBG Ticker	Name	iTraxx Sector	EOD 07-Feb 5y spread	27-Jan 07-Feb Av. Spread	Moody's	SP	Fitch	6m DTCC trading vol. (\$m)*
ALOPF	Alstom	Autos & Ind.	178	189	Baa3 NEG	BBB NEG	NR	6,178
PFOURS	Play Finance 2 SA							
TVNPW	TVN Finance Corporation III AB							
VUECIN	Vougeot Bidco plc							
RXLFP	Rexel SA							
ASTIM	Astaldi SpA							
ALTICE	Altice Finco SA							
ADVINT	Equiniti Newco 2 plc							
TCGLN	Thomas Cook Group plc							
TAKKO	Takko Luxembourg 2 SCA							
BULENR	Bulgarian Energy Holding EAD							
GESTAM	Gestamp Funding Luxembourg SA							
ELPEGA	Hellenic Petroleum Finance plc							
TEREOS	Tereos SA							

Source: Citi Research, Markit, Bloomberg. \*: Total DTCC trading volumes since 6-Sep-13.

Figure 5. Crossover membership at a glance<sup>4</sup>

The iTraxx Crossover index is designed to serve as a reference for the European high yield CDS market.

The index includes European high yield issuers with liquid CDS traded and, if there are less than 60 issuers with enough CDS liquidity, a number of issuers which have been active in the new issue market but do not yet have a liquid CDS contract traded. All the credits in iTraxx Crossover need to satisfy the following rules:

- **Ratings:** Crossover companies need to be either not rated by any rating agency or be rated BBB-/Baa3 with negative outlook (or watch) by at least one rating agency.
- **Lower spread cut-off:** Crossover companies need to trade wider than twice the average spread of the constituents of the iTraxx Non-Financial Index.<sup>5</sup>
- **Higher spread cut-off:** Crossover companies need to trade tighter than 50% upfront (plus 500bp running coupon).<sup>6</sup>
- **Debt:** Crossover companies need to have issued or guaranteed more than €100 million publicly traded debt securities (which shall be taken to exclude loans and equities) with a maximum remaining maturity of 30 years.
- **Ownership/guarantees:** If it is confirmed that one entity has more than 50% of the voting rights of another entity (directly or indirectly), then the most liquid entity qualifies for index membership. If a company is guaranteed by or guarantees another one only the most liquid is eligible.

Before the index roll, DTCC publishes an "Index Roll Report" with the top 1,000 traded single name CDS for the 6 months prior to the month of the roll. This is the list used to select the single name CDS which will form part of the Crossover index "Liquidity List". If there are more than 60 credits in the DTCC report eligible for Crossover inclusion, the 60 most liquid are chosen. If there are less than 60 credits in the DTCC report eligible for Crossover inclusion, Markit forms a "Supplementary List" with credits which satisfy all other requirements for Crossover inclusion and (i) have issued a minimum of €500m of new debt over the past 12 months (at least €250m in EUR/CHF/GBP) and (ii) have senior unsecured debt outstanding (at least a bond with an amount outstanding of €200m or above). The final portfolio comprises of a maximum of 60 names with the highest ranking entities from the Liquidity List (sorted by DTCC trading volumes) and if required, the Supplementary List (sorted by debt issued over the past 12 months).<sup>7</sup>

Source: Markit, Citi Research.

<sup>4</sup> The official iTraxx index rules can be found in Markit's website. This is our interpretation only.

<sup>5</sup> Average spreads over the last 10 business days of the month prior to the roll date are considered.

<sup>6</sup> Average spreads over the last 10 business days of the month prior to the roll date are considered.

<sup>7</sup> This is the rule for Series 20, which Markit has still not updated for Series 21: If less than 50 entities are available from the Liquidity List, the total number of entities selected from the Supplementary List will be calculated by adding 5 entities to the number of entities from the Liquidity List. Names are then removed from the list (if required) so that the total number of entities is rounded down to the nearest multiple of 5.

## iTraxx Main

**iTraxx Europe Main** contains the **125 most liquid investment grade** CDS contracts with the following sector break-down: 30 Autos & Industrials, 30 Consumers, 20 Energy, 20 TMT and 25 Financials.

Liquidity is measured by DTCC trading volumes and, for iTraxx Main purposes, a credit is considered “investment grade” if it is rated higher than BBB- negative outlook/watch by all rating agencies that rate it.

- **Autos and Industrials – 4 potential changes:** **Alstom** would leave the index given its downgrade to Baa3 Negative by Moody's last month. **Addeco**, **Deutsche Post** and **Linde** would likely leave the index due to low trading volumes. We expect **Conti** (after last year's upgrades by Moody's and S&P), **Gecina**, **Unibail** and **Rhodia** to enter the index given that they currently are the candidates with the highest trading volumes. There is a small trading volume difference between Rhodia and Linde, so this change will very much depend on trading volumes until the end of February.
- **Consumers – 2 potential changes.** Using available trading volumes, **Svenska** and **Henkel** would leave the index, being replaced by **SABMiller** and **Cadbury**. If Markit deems “Cadbury Holdings” to be incorporated in the US, it would not enter the index, and as a consequence Svenska would not leave it – using current data.
- **Energy – No expected changes.**
- **Financials – No expected changes.**
- **TMT – 1 potential change.** We expect **Kabel Deutschland** (KABEGR) to enter the index after last year's rating upgrades, replacing **SES** (the TMT entity in the current index with lowest trading volumes).

Figure 6. iTraxx Main: Potential credits leaving the on-the-run index

Credits which are part of Series 20 but are at risk of not being included in Series 21. Spreads in bp.

BBG Ticker	Name	iTraxx Sector	EOD 07-Feb 5y spread	27-Jan 07-Feb Av. Spread	Moody's	SP	Fitch	6m DTCC trading vol. (\$m)*	Reason for leaving
ADENVX	Adecco S A	Autos & Ind.	83	83	Baa3 STABLE	BBB STABLE	NR	1,277	Liquidity
ALOPF	Alstom	Autos & Ind.	178	189	Baa3 NEG	BBB NEG	NR	6,178	Ratings
DPW	Deutsche Post Ag	Autos & Ind.	38	38	Baa1 POS	NR	BBB+ STABLE	1,398	Liquidity
LINGR	Linde Ag	Autos & Ind.	38	39	A3 STABLE	A+ STABLE	NR	1,417	Liquidity
HENKEL	Henkel Ag & Co Kgaa	Consumers	36	37	A2 STABLE	A STABLE	A STABLE	1,123	Liquidity
SCACAP	Svenska Cellulosa Ab Sca	Consumers	65	65	Baa1 STABLE	BBB+	NR	1,082	Liquidity
SESGFP	Ses	TMT	69	69	Baa2 STABLE	BBB STABLE	BBB STABLE	1,013	Liquidity

Source: Citi Research, Markit, Bloomberg. \*: Total DTCC trading volumes since 6-Sep-13.

Figure 7. iTraxx Main: Potential credits entering the on-the-run index

Credits which are not part of Series 20 but are likely to be included in Series 21. Spreads in bp.

BBG Ticker	Name	iTraxx Sector	EOD 07-Feb 5y spread	27-Jan 07-Feb Av. Spread	Moody's	SP	Fitch	6m DTCC trading vol. (\$m)*
CONGR	Conti Ag	Autos & Ind.	93	95	Baa3 STABLE	BBB	NR	11,455
GFCFP	Gecina	Autos & Ind.	108	104	Baa2 STABLE	BBB POS	NR	1,764
ULFP	Unibail Rodamco Se	Autos & Ind.	74	73	WR	A STABLE	A STABLE	1,540
RHA	Rhodia	Autos & Ind.	45	45	Baa2 NEG	BBB+ STABLE	BBB+ *	1,477
SABLN	Sabmiller Plc	Consumers	61	58	Baa1 STABLE	BBB+ POS	BBB+ POS	1,848
KFT	Cadbury Hldgs Ltd	Consumers	27	27	Baa1 STABLE	NR	BBB STABLE	1,178
KABEGR	Kabel Deutschland V.	TMT	49	48	Baa2 POS	BBB+	BBB+ *	2,800

Source: Citi Research, Markit, Bloomberg. \*: Total DTCC trading volumes since 6-Sep-13.

## Analytics, Past Trade Ideas & Publications

Figure 8. Analytics – Available at Citi Velocity

Options	<a href="#">iTraxx Volatility Report</a> <a href="#">CDX Volatility Report</a> <a href="#">European Cross-Asset Volatility Report</a> <a href="#">Volatility P&amp;L Report – Credit Indices</a>	Tranches	<a href="#">iTraxx Series 9 Tranche Report</a> <a href="#">iTraxx Series 19 Tranche Report</a>
Curves	<a href="#">iTraxx Curve P&amp;L Report</a>	Indices	<a href="#">CDS Indices Positioning Report</a> <a href="#">CDS Indices Trading Volumes Report</a>

Source: Citi Research.

Figure 9. Past Trade Ideas

Options -	<a href="#">Sell Main vol. buy SenFin vol</a>	21 Jan 2014
Tranches -	<a href="#">More mezz. less seniors - 3-6% vs. super senior</a>	15 Jan 2014
Options -	<a href="#">SenFin vs. Xover Recs</a>	9 Jan 2014
Options -	<a href="#">Payer spread vs. index long</a>	9 Jan 2014
Options -	<a href="#">Sell 1m Main straddles</a>	9 Jan 2014
Options -	<a href="#">Sell Crossover Receiver</a>	9 Jan 2014
Options -	<a href="#">Sell strangles and go on holidays: Position for spreads to stay in the recent range in mid-January</a>	9 Dec 2013
Tranches -	<a href="#">Sell S9 Jun-18 6-9% protection vs. Xover 5y S20</a>	15 Nov 2013
Tranches -	<a href="#">Sell S9 Jun-18 22-100% protection vs. light delta</a>	15 Nov 2013
Indices -	<a href="#">Long risk Senior Fins. vs. short risk Main</a>	5 Nov 2013
Options -	<a href="#">Crossover receiver ladders</a>	23 Oct 2013
Options -	<a href="#">Long risk CDX IG vs. Main via Receivers</a>	15 Oct 2013
Options -	<a href="#">Buy Senior Financials straddles vs. sell Crossover straddles</a>	9 Oct 2013
Tranches -	<a href="#">Long risk equity vs. short risk 3-6% in S19 Jun-16 (3y)</a>	26 Sep 2013
Tranches -	<a href="#">Long risk S19 Jun-18 (5y) 3-6% vs. 5y S20 Crossover</a>	26 Sep 2013
Tranches -	<a href="#">Long risk iTraxx S9 Jun-18 (10y) super senior vs. short risk CDX IG S9 Dec-17 (10y) super senior</a>	26 Sep 2013
Indices -	<a href="#">Equal Notional 3s5s Flatteners: Adding cautious longs by selling forward protection</a>	5 Sep 2013
Single Names -	<a href="#">Sub/Senior compression trades in European banks</a>	13 Aug 2013
Options -	<a href="#">iTraxx Senior Financials vs. CDX IG via Receivers</a>	7 Aug 2013
Tranches -	<a href="#">Sell Jun-16 3-6% Series 19 protection vs. Buy Jun-18 Series 9 index protection</a>	9 Jul 2013
Options -	<a href="#">Option trades ahead of the FOMC</a>	18 Jun 2013
Tranches -	<a href="#">iTraxx Series 9 vs. Series 19 Jun-18 equity tranches</a>	5 Jun 2013
Options -	<a href="#">Hedging via Crossover Bearish Ladders</a>	16 May 2013
Options -	<a href="#">Buy Main straddles: sell CDX IG straddles</a>	1 May 2013
Tranches -	<a href="#">Views &amp; Trades on iTraxx Series 9 Tranches</a>	18 April 2013
Single Names -	<a href="#">Beware of retail and food releveraging – short risk retailers &amp; food vs. Main Non-Financials</a>	18 April 2013
Options -	<a href="#">Receiver 1x2s – Mind the tail if going long</a>	2 Apr 2013
Single Names -	<a href="#">Long insurers vs. short premium autos</a>	19 Mar 2013
Tranches -	<a href="#">Flatteners in iTraxx Equity Tranches</a>	6 Mar 2013
Tranches -	<a href="#">Long risk 3-6% vs. short risk 0-3% - Jun-15 iTraxx Series 9 tranches</a>	12 Feb 2013
Options -	<a href="#">Long risk Main vs. Crossover via indices and receiver options</a>	12 Feb 2013

Source: Citi Research.

Figure 10. Other publications

2014 European Credit Outlook: <a href="#">Strategy // Positioning and Trades</a>	13 Jan 2014
<a href="#">Global Structured Credit Outlook: A Rockier Ride</a> (R Roy, A Basu, K Malhotra, R Brauchler)	20 Dec 2013
<a href="#">2013 Trading Volumes in European Credit: CDS Indices, Single Name CDS and IG Bonds</a>	5 Dec 2013
<a href="#">Credit Options - What did investors do in 2013?: What will they do in 2014?</a> (2013 European Credit Conference Presentation)	4 Dec 2013
<a href="#">Credit Index Options 1-0-1: Launching our option pricing tool @ CitiVelocity</a> (2013 European Credit Conference Presentation)	2 Dec 2013
<a href="#">Europe Returns: Assessing value across flow and structured credit assets</a>	22 Nov 2013
<a href="#">iTraxx Tranches Views &amp; Trades: Mezz may be back next year</a>	15 Nov 2013
<a href="#">Financial CDS to get a re-vamp</a>	7 Aug 2013
<a href="#">Hedging menu: payer spreads, 3s5s flatteners and Jun 15/18 equity tranche flatteners</a>	28 Mar 2013
<a href="#">What bail-in means for CDS</a>	11 Feb 2013

Source: Citi Research.



## Appendix A-1

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