

The Innovations of the markets managed by Borsa Italiana

The innovations introduced by Borsa Italiana in 2000 concerned all its equities, bonds and derivatives markets. Borsa Italiana demonstrated its commitment by creating new markets, offering new products and enhancing the organisational and operational context of the markets.

THE STOCK MARKETS: STOCK EXCHANGE AND NUOVO MERCATO

During 2000 Borsa Italiana introduced important changes to the regulatory framework of its markets, which led to both the creation of new trading environments and the innovation of those already existing.

The new segmentation of the Electronic Share Market (MTA) was defined in 2000, but is scheduled to start in April 2001. The project for the creation of the After Hours Market, on the other hand, was implemented the previous year.

In the course of the year, both the Stock Exchange and the Nuovo Mercato were also involved in other innovations which concerned various operational aspects of the management of the markets: the reduction in the contracts settlement cycle; the creation of the MIB-r index, valued at reference prices; the enlargement of possible listing on the Nuovo Mercato to include warrants and convertible bonds.

The new Stock Exchange segmentation and the STAR segment

Borsa Italiana decided to design a new structure for the MTA, with a view to making the Stock Exchange listing more and more representative of the Country's economic structure, creating market environments suited to the specific needs distinguishing the various Italian entrepreneurial situations.

The new segmentation of the Stock Market, according to the level of capitalisation, allocates equity instruments between blue-chip, STAR and "other securities"

The new segmentation of the Stock Market, due to coming into effect on 2 April 2001, is based on the capitalisation of listed equity instruments. Based on the consideration that the Italian industrial structure is made up of a high number of medium sized enterprises, a segment was set up especially designed for companies in this category which intend to commit themselves to acquiring enhanced visibility on the market.

The new market segments replacing those previously existing are:

- blue-chip segment, for securities with a level of capitalisation above that established by Borsa Italiana;
- STAR segment (*Segmento Titoli con Alti Requisiti* - High Standard Mid Cap Market Segment), for medium sized companies which, in order to enhance the quality of their image on the market and be included in the target of institutional investors, undertake to observe more stringent requirements in terms of liquidity, information transparency and corporate governance (table 3);
- “other securities” segment, for the other securities with capitalisation below the established threshold. Within such segment the securities will be divided into two categories based on their liquidity, measured in terms of trading frequency and daily average turnover.

TABLE 3 - ADDITIONAL REQUIREMENTS FOR SHARES TO QUALIFY AS STAR

SIZE	
Market capitalisation	STAR companies must have a market capitalisation of ordinary shares under 800 million euro. The level of this threshold is defined in the Instructions accompanying the Rules for the markets organised and managed by Borsa Italiana and may be subject to revision, when necessary, in view of the overall market performance.
LIQUIDITY	
Minimum float	The granting of STAR status is subject to an ordinary shares float of at least 35% for newly listed companies and of at least 20% for already listed ones. A free float of at least 20% is to be preserved; otherwise exclusion from the STAR market segment shall be put into effect.
Specialist	Specialists support the liquidity of the shares by displaying continuous bids and asks for minimum daily amounts with a percentage spread that does not exceed the limit established by Borsa Italiana. They also publish research reports about the company.
TRANSPARENCY	
Quarterly reports	They must be published within 45 days after the end of each quarter.
Statement of accounts in electronic format	All statements of account (quarterly, half-yearly, annual) must be made available to Borsa Italiana in electronic format. Through its own web site, Borsa Italiana will provide an application able to elaborate financial statement accounts in an easy way and according to the higher technical standards.
Information	The balance sheet, the half-yearly and quarterly reports, all “price-sensitive” information, as well as the documentation distributed in meetings with institutional investors are to be published both in Italian and English and to be posted on the company web site.
Investor Relations Specialist	The issuer shall appoint a professionally qualified in-house investor relations manager. The specialist is to publish yearly at least two research reports concerning financial half-year and year-end results, along with brief notes on quarterly results and information on the main company news. He also undertakes to organise at least two meetings a year between professional investors and company management. All these reports must be promptly made available to Borsa Italiana.
CORPORATE GOVERNANCE	
Non-executive independent directors	The Board of Directors must include non-executive and independent directors whose number and standing are such that their views carry significant weight in the Board's decision-making process.
Internal control committee	The issuer should appoint an internal control committee or specifically entrust the board of directors with the task of analysing and addressing problems of importance for the control of the company's activities.
Directors' remuneration	A significant part of the total remuneration for executive directors and higher management must be performance-related and linked to the achievement of individual targets or outstanding results.

Update: March 2001

The After Hours Market

The project to create an evening market was launched in the Autumn of 1999 and followed the positive experience of the extension of trading hours implemented at the beginning of September 1999. The fact of bringing forward by half an hour the start of continuous trading (from 10:00 am to 9:30 am) and extending the close by half an hour (from 5:00 pm to 5:30 pm) decided within the scope of harmonisation based on the European market model, led to the injection of new liquidity into the market without a simple dilution of the existing trades into new time frames.

The market was set up with the main intention of meeting the potential trading demand for domestic securities during the hours of closing of the Italian market. Analysis of the market environment led to identification of the retail investor as the main party interested in the new trading opportunity. The development of the procedures for access to the markets makes it possible to operate on the securities of Stock Exchanges which, even just due to time-zone differences, are open during the closing hours of the domestic markets and which, in any case, can influence the performance of the domestic market. Another category of intermediaries taken into consideration concerns institutional investors: mutual fund units are valued at reference price which, for its nature, in the present market structure can only be known after the end of the daily trading session. The interest in responding immediately to international market movements and the chance to adjust portfolio positions, at reference price if necessary, are needs that can be met through the creation of an evening market.

In defining the market structure, Borsa Italiana set itself four targets which guided the design of the market's microstructure, its regulatory framework and its technological implementation.

- Definition of a regulatory framework able to ensure the conditions of efficiency, transparency and guarantee typical of a regulated market, at the same time not requiring a mandatory presence on the market of reluctant intermediaries. With reference to the first consideration, the after hours market comprises two regulated market sections: the Trading After Hours (TAH), representing the Stock Exchange market section for trading the shares of the MIB30 and MIB30 indices and covered warrants; the Trading After Hours Nuovo Mercato (TAHNM) defined as the Nuovo Mercato section for trading shares supported by a specialist also during evening hours. As regards the second consideration, the evening session is positioned autonomously with respect to the daytime market (the orders ready on the book at the end of the daytime session do not automatically transfer to the after hours session, but are "frozen" and re-input during the following daytime session) and each intermediary can choose whether or not to access the evening market. In actual fact, most Borsa Italiana authorised intermediaries also operate during evening hours.

On 15 May 2000, in response to a specific market requirement, Borsa Italiana launched the After Hours Market, the first European regulated market for trading after the close of the daily market

Trading After Hours takes the form of a service offered to the market; its organisational structure allows intermediaries to choose whether or not to participate

- Satisfaction, with a single model, of the various components of the demand for evening trading. The evening trading session opens with a cross-order book phase, dedicated first of all to professional investors, and proceeds with a continuous trading phase which meets the interest of private investors. During the cross-order book phase - lasting ten minutes from 5:50 pm to 6:00 pm - contracts may be executed at the reference price with cross-order functionality, thus exploiting the possibility to automatically match two orders of opposite sign, for equal amounts and with known counterparts. The evening continuous trading phase differs from the daytime phase only as regards the dimension of the parameters controlling the regular performance of trading.
- Creation of the conditions for an efficient process of price formation during the evening session. In order to avoid distorting effects on the closing phase of the daytime market, the minimum turnover of the cross-order book phase has been set at 25,000 euro for shares and 10,000 euro for covered warrants. In order to avoid excessive and unjustified

The securities admitted to evening trading are the shares included in the MIB30 and MIDEX indices, the shares of the Nuovo Mercato when backed by a specialist and covered warrants upon request of the issuer

price fluctuations, during the continuous trading phase the parameters for automatic control of trading have been reduced. Price variation divergences have been determined according to the instrument traded:

- ✦ for shares, a price variation range has been identified that will take into account the evening overnight volatility shown by securities during 1999: the ceiling for variations in the price of orders with respect to the reference price for the day is equal to $\pm 10\%$; the ceiling for variations in the price of contracts with respect to the reference price for the day is equal to $\pm 3.5\%$; owing to the reduced level of the aforesaid ceiling, there is no variation limit on prices between two consecutive contracts;
- ✦ as regards covered warrants, wider parameters have been defined in view of the greater volatility of the instrument and the presence of market makers who undertake to create conditions of minimum market liquidity: the ceiling for variations in the price of orders with respect to the reference price for the day is equal to $\pm 900\%$; the ceiling for variations in the prices of contracts with respect to the reference price for the day is equal to $\pm 30\%$; the variation limit on prices between two consecutive contracts is equal to $\pm 15\%$.

As occurs for the daily session, evening trading is supported by an active market surveillance which ensures the possibility, when appropriate based on market conditions, to enlarge the parameters controlling the price formation process.

Taking into account the lower level of liquidity of an evening market, the prices realised during the evening session are not used as reference parameters for the transactions carried out during the following day's daytime trading session.

- Restriction of technological and operational interventions. The trading platform adopted is the same as the MTA for shares and the MCW for covered warrants. Moreover, the changes introduced to the trading system have not required substantial operational modifications.

The settlement of trades carried out during the evening market follows the same timing as the contracts concluded on the daytime market.

Other innovations regarding the organisation and management of the stock markets

Completing the operational environment of the stock markets in 2000, certain changes were introduced involving both the MTA and the Nuovo Mercato.

- Reduction of the contract settlement cycle. Starting 28 March 2000, in order to enhance efficiency and security during the trading and settlement phases and continuing in the process of bringing the rules for the operation of the markets into line with international standards (European market model), the settlement cycle for contracts relating to financial instruments listed on the Stock Exchange, the Nuovo Mercato and the Mercato Ristretto have been reduced from five to three trading days following the execution of the trade.
- Changes concerning the Stock Exchange indices. In view of the new requirements of institutional investors as regards increasing the value of managed portfolios, on 3 January 2000 the MIB-r was introduced, a synthetic index weighted and valued at reference prices. The calculation algorithms for this index do not vary with respect to those used for the baskets currently managed. At the same time, in order to avoid confusion in determining the performance of the market, the current versions of the MIB and IMR indices (i.e. those rebased at the beginning of each year) were eliminated, keeping in operation only the historical versions.
- Expansion of the range of financial instruments admitted on the Nuovo Mercato. The Nuovo Mercato was created as a market for the ordinary shares of companies with high growth potential. The increasing interest in these companies and the evolution of their financial culture has taken them to issue financial instruments other than shares, such as for example warrants, bonds and convertible bonds. The emergence of such factors has therefore induced Borsa Italiana to expand the range of financial instruments admitted on the Nuovo Mercato to include direct issues of warrants and bonds convertible to shares listed on the Nuovo Mercato. As regards private bonds, on the other hand, it was decided to centralise on the MOT also the issues of Nuovo Mercato companies.

From 28 March 2000 the settlement cycle of trades on equity securities has been reduced to t+3

During 2000 Borsa Italiana expanded the set of financial instruments admitted to listing on the Nuovo Mercato to include warrants and convertible bonds

THE COVERED WARRANTS MARKET (MCW)

Covered warrants, included in the set of financial instruments offered by Borsa Italiana since 1998, were initially traded on the MTA and, up to the early months of 2000, shared its regulatory framework and trading platform.

The difference in characteristics with respect to shares caused Borsa Italiana to define, still within the Stock Exchange environment, a regulatory framework specifically designed for covered warrants. This intervention made it possible to better distinguish the trading environment of covered warrants, adapting it to the peculiarities of supply and demand in terms of trading, market participation of the parties concerned, pricing and technological structures.

Due to the strong growth in these instruments, seen from the high increase in the number, type of issues and turnover, it became necessary to create a specially dedicated trading

platform, with consequent positive effects as regards rationalisation of the use of technological resources and reliability of performance of the electronic trading architectures.

On 28 February 2000 the Electronic Covered Warrants Market (MCW) was set up, as a segment of the Stock Exchange regulated market; on July 24th the trading platform specially created for MCW came into operation

The market trading model did not see substantial changes with respect to its original design: only the continuous trading procedure is envisaged in the form of order-driven market with the participation of market maker intermediaries committed to ensuring a minimum level of liquidity for each series listed. In particular, the issuer of covered warrants undertakes - directly or by assigning the task to a third party - to continuously display on all series listed bid and offer prices for a quantity equal at least to the minimum trading lot. Borsa Italiana nevertheless reserves the right to increase, at the moment of admission to listing, the quantities required for listing purposes.

Two changes introduced during 2000 are significant for the purpose of both ensuring regularity of the pricing process and determining trading session representative prices.

- Enlargement of the price variation limits for the automatic control of trading regularity. Due to the high volatility distinguishing covered warrants trading it became necessary to widen the price variation divergence for the input of orders to the market and for the execution of contracts. In order to enhance the continuity of trading and to reduce the impact of suspensions on the operations of intermediaries and investors, the maximum variation limits have been increased: as regards the prices of orders with respect to reference prices from $\pm 90\%$ to $\pm 900\%$; as regards the prices of contracts with respect to reference prices from $\pm 30\%$ to $\pm 50\%$ and as regards the prices of two consecutive contracts from $\pm 15\%$ to $\pm 30\%$.
- Method of calculating trading session representative prices. In order to ease the burden on the system as regards the end-of-session calculation tasks and considering that for the covered warrants the most important information relates to a summary of the last trades carried out on each financial instrument, the calculation of the official price has been brought into line with that of the reference price (weighted average relating to the last 10% of total quantity traded).

An important innovation has been introduced with regard to the admission requirements for covered warrants. In order to render these instruments more easily comparable, the elements distinguishing the listed series have been standardised.

- Number of underlying assets for each instrument (par or multiple): for the series referred to Italian equities, the ratio between the number of underlying assets and covered warrants must be 1:10 (multiple equal to 0.1); if the underlying is an index managed by Borsa Italiana, the ratio must be 1:10,000 (multiple equal to 0.0001).
- Expiry date: regardless of the nature and nationality of the underlying asset, the expiry date must be fixed on the last trading day of the week.
- Settlement price: if the underlying is made up of shares, the reference price is considered as the settlement price; if the underlying comprises an index managed by Borsa Italiana, the opening value is considered.

- Exercise of option at expiry date: provision has now been made for the option contained in the covered warrant to be automatically exercised at expiry in cases where it is in the money, i.e. when the difference between settlement price and exercise price of the covered warrant is positive in the case of a call and vice versa in the case of a put. The issuer undertakes to pay the positive difference to the investor, failing specific waiver on the part of same.

THE MARKETS FOR FIXED-INCOME INSTRUMENTS

17 January 2000 saw the inauguration of the EuroMOT, the new regulated market for trading eurobonds, bonds of foreign issuers and Asset-Backed Securities (ABS).

The EuroMOT was set up following the interest shown in the instruments of the euromarket and the coming into force of law 130 of 30 April 1999 which, by regulating the provisions on debt securitisation, made it possible to introduce the ABS also in Italy.

From a regulatory standpoint, the EuroMOT is organised as a segment of the Stock Exchange and, together with the MOT, defines the operational trading environment for fixed-income instruments in regulated markets.

As regards market structure, the EuroMOT comprises three segments assigned for trading respectively in eurobonds, ABS and foreign securities. The three segments currently have the same procedures and trading hours. In particular, only the continuous trading method is adopted, set up in the order-driven form, with the mandatory presence of a specialist for each instrument admitted.

Only limit orders may be entered and contracts are concluded via the automatic matching of compatible orders with opposite signs, based on price-time priorities. The EuroMOT specialist undertakes to support the liquidity of its financial instruments guaranteeing the continuity of trading and the existence of price references. To this end the specialist continuously displays on the trading systems bids and offers for a minimum quantity and within the maximum price differential established by Borsa Italiana based on the characteristics of the instrument.

As regards the participation of the intermediaries, specific rules have been defined: in particular, in order to be admitted to the trading of instruments not settled through the Italian clearing and settlement service, the intermediaries must directly or indirectly participate in the foreign depositary and settlement systems wherever the instruments are deposited.

The creation of the EuroMOT comes within the scope of the project to streamline the trading environment for fixed-income instruments managed by Borsa Italiana with the objective of setting up a segment suited to the characteristics of the typical instruments of the euromarket

THE EQUITY DERIVATIVES MARKET

The innovations of the IDEM during 2000 concerned, in particular, the expansion of the range of tradable instruments.

In chronological order, the first intervention was directed at introducing the trading of option contracts on the securities of the Nuovo Mercato. Based on the criteria laid down by Borsa Italiana, the possibility was introduced to include in the shares underlying the stock options also the shares listed on the Nuovo Mercato.

Subsequently, and specifically on 3 July 2000, the range of Borsa Italiana derivatives was further enhanced with the miniFIB, the new futures contract on the MIB30 index designed with the characteristics of the retail investor in mind. The decision to create a new contract rather than change the existing one was based on the consideration that it is precisely its dimension that makes the futures contract on the MIB30 highly appreciated by professional investors. The miniFIB is one fifth of the size of the futures on the MIB30, making it possible to open positions on the MIB30 index while investing more limited economic resources. The contractual specifications of the miniFIB (table 4) differ from those of the futures on the MIB30 only as regards the value of the index point and hence the size of the contract.

TABLE 4 - MINIFIB: CONTRACT SPECIFICATIONS

Contract specifications	Description
Underlying	MIB30 index.
Quotation	Index points.
Multiplier	€ 1 each index point.
Contract size	€ 1 x futures price (expressed in index points).
Minimum tick size	5 index points.
Expiration months	The two closest quarterly expirations (March, June, September, December).
Settlement	Equal to the value of the settlement price multiplied by 1 €. Cash settlement on the first business day following expiration.
Last trading day	9:30 am of the third Friday of the expiration month (where this is a non-trading day, the maturity day shall be the first trading day before such day).
First trading day	First subsequent trading day after the last trading day.
Daily settlement price	The same as the price of MIB30 futures, calculated on the basis of the weighted average prices, of the last 10% of the MIB30 futures traded.
Settlement price	The same as the settlement price of MIB30 futures, which shall be equal to the value of the MIB 30 index calculated on the opening prices of the financial instruments making up the index recorded on the last trading day. Where the opening prices of one or more of the financial instruments making up the index have not been determined by the end of the session, Borsa Italiana shall fix the price of such financial instruments, in order to determine the value of the index, on the basis of the prices recorded in the last session, taking account of any other objective elements that may be available.
Margins	They are calculated by the Cassa di Compensazione e Garanzia (Italian clearing house). The initial margin is equal to 7.5%.
Give-up	Available.
Trading hours	9:15 am - 5:30 pm.

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