

The Innovations of the markets managed by Borsa Italiana

Ever since its first year of operation, Borsa Italiana's objective has been to meet the needs of all market components (issuers, intermediaries and investors). While 1998 may be remembered as the year of transition from a model of publicly to one of privately managed markets, 1999 emerged as the year of continuity in the market enhancement process and 2000 as the year of growth based on the innovations previously introduced in terms of both market functionality and management. The three years from 1998 to 2000 therefore built the foundations for a winning market formula, which in 2001 saw Borsa Italiana committed to achieving excellence in all its areas of operation.

With specific reference to markets, table 1 defines the operational framework of Borsa Italiana, synthesising the structure of the markets the same organise and manages.

TABLE 1 - THE ORGANISATIONAL STRUCTURE OF BORSA ITALIANA MARKETS

CASH MARKETS	DERIVATIVES MARKETS
<p>Stock Exchange - MTA⁽¹⁾ -</p> <ul style="list-style-type: none"> ✦ Shares ✦ Warrants 	<p>IDEM</p> <ul style="list-style-type: none"> ✦ Index futures ✦ Index options ✦ Stock options
<p>Nuovo Mercato⁽¹⁾</p> <ul style="list-style-type: none"> ✦ Convertible bonds ✦ Pre-emptive rights 	
<p>Mercato Ristretto</p> <ul style="list-style-type: none"> ✦ Closed funds⁽²⁾ 	
<p>Stock Exchange - MCW⁽¹⁾ -</p> <ul style="list-style-type: none"> ✦ Covered warrants 	<p>MIF</p> <ul style="list-style-type: none"> ✦ Interest-rate futures ✦ Options on interest rate futures
<p>Stock Exchange - MOT -</p> <ul style="list-style-type: none"> ✦ Government bonds ✦ Private bonds 	
<p>Stock Exchange - EuroMOT -</p> <ul style="list-style-type: none"> ✦ Eurobonds ✦ Asset Backed Securities ✦ Foreign bonds 	

(1) After hours section included (TAH for MTA and MCW, TAHnm for Nuovo Mercato).

(2) Listed and traded only on Stock Exchange - MTA.

Note: the regulatory structure of markets is completed with the electronic traditional option market (MPR) included in the Stock Exchange.



THE STOCK MARKETS: STOCK EXCHANGE AND NUOVO MERCATO

2001 was a year of major changes involving all the Borsa Italiana stock markets: the Electronic Share Market (MTA), the Nuovo Mercato, and also the Mercato Ristretto, to which some of the innovations introduced on the other markets were extended.

Correspondence with the characteristics of the Italian real economy and fulfilment of the financial market customer needs were the guidelines for the adoption of a new segmentation of the MTA and the standardisation at European level of the Italian market model. The changes introduced in the composition of the MIB30 index and the creation of the MIB STAR and NUMTEL indices are tending in the same direction.

The operational framework of the markets was also completed with a series of interventions directed towards further enhancing the management of the stock markets with regard to both the secondary market and compliance on the part of issuers.

THE NEW SEGMENTATION OF THE ELECTRONIC SHARE MARKET

On 2 April 2001 the new segmentation of the Electronic Share Market (MTA) came into effect, defined with a view to making the official Stock Exchange market list more and more representative of the Country's economic reality, which alongside the large-scale companies, features a considerable number of small and medium-sized enterprises (SME). Size, as a distinguishing element of the Italian entrepreneurial system, replaced liquidity as the guiding criterion for designing the new market structure.

Based on the capitalisation of the main share and in order to give full value to the SME wishing to maximise their performance potential, three segments have been created: one - blue-chip - for the largest companies and two - STAR and ordinary segment - for the small and medium-sized enterprises.

- The **blue-chip segment** includes the shares of companies where the capitalisation of the main share is above the level of the threshold established by Borsa Italiana which, during 2001, was set at a value of 800 million euro.
- The **STAR segment** (*Segmento Titoli con Alti Requisiti* - High Standard Mid Cap Market Segment) includes the shares of medium-sized companies wishing to maximise the value of their listing on the market by observing more stringent requirements in terms of diffusion of shares, transparency, corporate governance and trading procedures. Qualification for STAR status is optional and reserved for companies whose main shares have a capitalisation below the threshold level established for the purposes of segmentation. The additional requisites ascribe to the companies possessing them higher qualitative standards with consequent positive effects in terms of image and visibility with institutional investors and the generality of the market.

The segmentation of the Electronic Share Market, which since 2 April 2001 has comprised three segments - blue-chip, STAR and ordinary segment - is revised twice a year, in the months of March and September

- ◆ Distribution of shares among the public - As regards newly-listed companies, to qualify for STAR status it is required a minimal distribution of shares among the public equal to 35% of share capital. This percentage may also include the quantity of shares allocated for the purpose of the “green shoe”, up to the limit of 10% of the value of the offering. For the companies already listed requesting STAR status, a minimum free float of 20% is required, a percentage also corresponding to the requisite for remaining in the STAR segment.
- ◆ Transparency - For the STAR companies the market benefits from a wider and more timely assortment of information: the quarterly report must be published within 45 days of the close of each quarter; balance sheet, half-yearly report and quarterly reports must be reclassified and transmitted electronically to Borsa Italiana which, in

STAR, in its capacity as high quality segment, imposes on all participating companies stringent requirements in terms of distribution of shares among the public, transparency, corporate governance and liquidity

turn, makes them available on its website through a special application that facilitates re-elaboration. To ensure maximum diffusion of information also abroad, STAR issuers undertake to publish on their website, in Italian and English, the information required under existing regulations.

- ◆ Corporate Governance - An essential aspect of STAR status concerns obligations relating to the organisational structure of the company. In particular: the Board of Directors must be made up of non-executive and independent directors who, for their number and standing, carry significant weight in the board's decision-making process; analysis of procedures related to the control of corporate business must be assigned to an

internal control committee or, in its absence, to the Board of Directors as a whole; an “investor relator” must be appointed with specific responsibility for promoting relations between the company and investors; lastly forms of top management incentive must be provided whereby a significant portion of management remuneration is linked to the attainment of established individual objectives and/or economic results achieved by the company.

- ◆ Appointment of a specialist - The STAR issuer must appoint a specialist who, for the entire period during which the shares are traded in the segment, undertakes to perform a dual role: to support the share's liquidity and contribute to the diffusion of reliable information on the company.

From a liquidity standpoint, the specialist assures his presence on the market displaying continuous bids and asks satisfying some parameters established by Borsa Italiana (table 2): obligations are grouped under three classes and defined in terms of minimum daily quantity obliging the specialist to remain on the order book, minimum size of each single order and maximum spread within which orders must be entered. Market obligations are updated on a six-monthly basis to coincide with the periodic revision of the market segmentation.

With regard to information, the specialist is obliged to produce, promptly and in keeping with the best standards, at least two financial reports per year, to coincide, one with the publishing of the annual financial statements and the other with the half-yearly information. Completing the specialist's information obligations is his commitment to organise at least two meetings each year between the management of the company and professional investors.



The importance given by Borsa Italiana to developing the STAR segment and hence the Italian SMEs, is confirmed by the services directed towards enhancing the visibility of the companies acquiring the high quality status.

- ✦ Via the Borsa Italiana website, domestic and international professional investors, using a special password, can access a “one stop shop” service that offers data, research reports and all other financial information required to know all aspects of STAR companies. Particularly important in this connection are the agreements with the providers Thomson Financial and JCF. The service organised jointly with Thomson Financial makes available to professional investors on the Borsa Italiana website research reports published on STAR companies by the specialists and by the other analysts supplying Thomson Financial. The service organised in collaboration with JCF enables professional investors to carry out in-depth analyses through: access to the financial statements of the last three years reclassified by the STAR companies; availability of the “consensus” on the main economic, financial and balance sheet indicators produced by the specialists and by the other analysts supplying JCF; the possibility to customise projections and the availability of studies on the main comparable companies.
- ✦ The relationship between the issuer and the market is facilitated by the formation of a team of account managers specifically assigned to the STAR companies.
- The **ordinary segment** includes the securities of mid and small companies not wishing to acquire STAR status, although they want to enjoy the advantages of being listed on the Stock Exchange. The companies belonging to the segment satisfy the requisites for admission and continued inclusion established for blue-chip companies, but the securities are traded according to procedures and hours that are differentiated based on liquidity, measured in terms of daily average turnover (table 3) and frequency. In this regard two classes are defined: class 1 extends for reduced hours, providing however for a division between auction and continuous trading the same as for the blue-chip and STAR segments; class 2 adopts the same hours as class 1, but is made up of an opening auction immediately followed by a closing auction.

TABLE 2 - MARKET OBLIGATIONS OF SPECIALISTS ON STAR SHARES

Daily average turnover⁽¹⁾	Minimum daily quantity⁽²⁾	Maximum spread	Minimum size of each order
Up to 150,000 euro	50,000 euro	3.5%	2,500 euro
150,000 - 500,000 euro	75,000 euro	3.0%	2,500 euro
Over 500,000 euro	100,000 euro	2.5%	2,500 euro

(1) The obligations of the specialists on the market are determined based on daily average turnover in the six preceding months (March-August or September-February) for shares subject to the obligation. For newly-listed companies, the liquidity of shares with equal capitalisation is considered.

(2) For each trading session, the specialist undertakes to sustain the liquidity of the instrument until the execution of trades, operating as a specialist, for a value at least equal to the minimum daily quantity. Afterwards, the specialist may continue to operate as a specialist on a voluntary basis.

THE EUROBIT MARKET MODEL

Between the end of 1999 and 2000 the main European Exchanges were engaged in a project to standardise trading procedures, leading to the identification of a shared model of market microstructure (European Market Model).

With the adoption of the EuroBIT market model elements of quality were introduced to complete the process of optimisation of the market microstructure : For the Italian stock markets, in many ways already compatible with the European market model, Borsa Italiana designed the EuroBIT market model, the European market model adapted to the characteristics of the Italian market, and programmed its implementation process. On 3 December 2001 the first and most significant phase came into operation accompanied by important innovations, such as: introduction of the closing auction, with consequent change of trading hours; adoption of the control price as the new value for the automatic checking of trades; same changes in the types of orders.

Closing auction

The closing auction was introduced with the main objective of enhancing the price formation process during the final phase of the trading session. Through concentration of buying and selling interests present on the market at the end of the trading session into a single moment of time, it is possible to establish a more significant closing price.

The closing auction - which, like the opening auction, operates and comprises the pre-auction, validation and auction (conclusion of contracts) phases - has a starting time and duration that differ according to the segment and market of which it is part:

- for securities traded in the blue-chip and STAR segments of the Electronic Share Market (MTA) and in the Nuovo Mercato: pre-auction from 17:25 to 17:35; validation and conclusion of contracts from 17:35 to 17:40;
- for securities traded in the class 1 of the ordinary segment: pre-auction from 16:25 to 16:35; validation and conclusion of contracts from 16:35 to 16:40;
- for securities traded in the class 2 of the ordinary segment and in the Mercato Ristretto: pre-auction from 11:00 to 16:35; validation and conclusion of contracts from 16:35 to 16:40.

Due to the adoption of the closing auction, regulation of the After Hours Market has been changed with the elimination of the cross-order book phase, the trading method that previously opened the evening market. The cross-order book phase was in fact designed to cater above all for the need of the institutional investors to trade at the reference price. Its usefulness no longer applies since the closing auction, although the auction price is not yet used as reference price, allows trades to be executed at significant closing prices where there is no “market impact”.

The change in stock market trading hours also affected the hours of the markets in which derivatives and covered warrants are traded (table 3): as regards IDEM, the hours have been extended to 17:40 (from 17:30) to coincide with the end of the closing auction, while the close of the Covered Warrants Market has been changed to 17:25 (from 17:30) to coincide with the end of the continuous trading phase of the daily market.



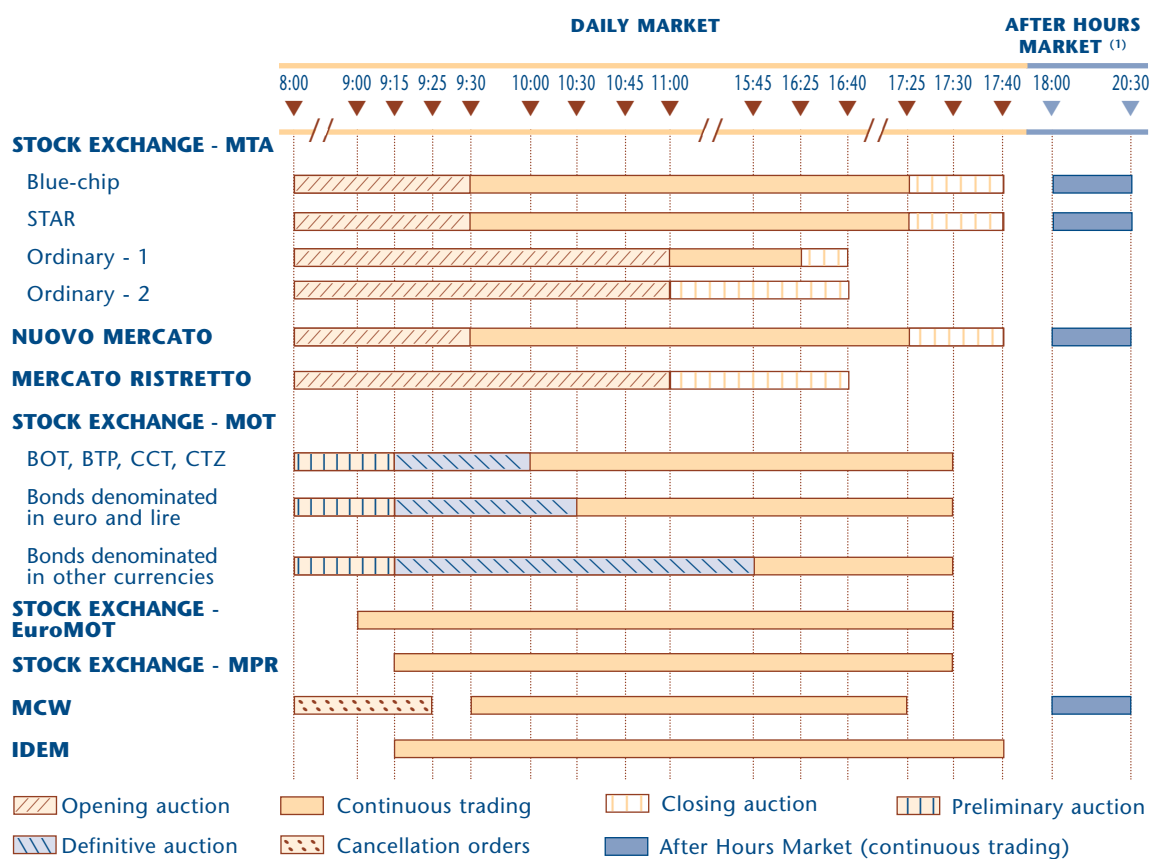
Control price

The control price is the price guiding the automatic checking of trades with a view to ensuring market integrity and the regular course of trading. The automatic control of maximum price variations is carried out at all times during the trading session based on the control price which, in the course of the trading session, is updated as follows:

- during the pre-auction, validation and opening phases of the opening auction, it equals the reference price of the previous day;
- following validation of the first opening price, such price is taken as control price during the continuous trading and closing auction phases and remains constant up to the end of the daytime session;
- at the end of the daytime market, the control price is updated with the reference price of the day and is used to guide the process of price formation for the After Hours Market and the following day's opening auction.

Up until 30 November 2001, the automatic control of trading was guided by the reference price which, since it was calculated once only at the end of the trading session, tended to

TABLE 3 - TRADING HOURS OF BORSA ITALIANA MARKETS



(1) On After Hours Market may be traded shares belonging to MIB30, Midex and Nuovo Mercato (only in presence of a specialist) and covered warrants (on request of the issuer and in presence of a market maker). If sustained by a specialist, even blue-chip shares (not included in MIB30 and Midex) and STAR shares may be traded on the After Hours Market.

Update: March 2002.

define a fixed interval of variation for the prices of contracts, except for specific supervisory interventions when necessary, throughout the entire session. From December 3rd, 2001 the automatic checking of trades is based on the control price, which is updated as a result of the definition of the opening price and of the reference price. The control price makes it possible to define a price range updated to reflect the new market conditions emerging at the opening of the new trading day. As an example, and in order to call attention to the operating differences compared to the previous situation, let us assume a case where the reference price of the day (t-1) equals 100 euro. Bearing in mind that the static range of price variation is defined at approximately $\pm 10\%$ of the guide price for the automatic checking of trading, until November 30th, the contract prices could vary, during the course of the entire trading session, between 90 and 110 euro. From December 3rd, the 90-110 euro interval is used for the validation of the theoretical opening price; subsequently, once the opening price has been calculated, the range updates based on the opening price which becomes the control price. If, for example, the opening price was 107 euro, the new static range for variation of the prices for continuous trading and opening auction would be 96.30 - 117.70 euro. As regards the After Hours Market (if the security can be traded also during this session) the interval would change again due to the adjustment of the control price which would become equal to the reference price (during the evening market the static range of price variation amounts to $\pm 3.5\%$ of the control price). Table 4 shows a summary in chart form of the dynamics of the automatic trading regularity control process guided by the control price.

TABLE 4 - THE NEW CONTROL PRICE: DEFINITION OF THE STATIC PRICE RANGE FOR SHARES

	Day (t-1)	Day (t)				Day (t+1)
		Opening auction	Continuous trading	Closing auction	After Hours	Opening auction
					+ 3.5% (115.92 euro)	+ 10% (123.20 euro)
			+ 10% (117.70 euro)		<div style="border: 1px solid black; padding: 5px;"> The prices forming during the evening market and the daytime opening auction price (t+1) are included within a price interval defined based on the control price (t) equivalent to the reference price (t) </div>	
Reference price (t-1) = 100 euro = Control price	<div style="border: 1px solid black; padding: 5px;"> The opening price (t) is between $\pm 10\%$ with respect to the control price (t-1), hence between 110 and 90 euro </div>		<div style="border: 1px solid black; padding: 5px;"> The prices forming during the course of continuous trading and the closing auction price are included in the range of $\pm 10\%$ with respect to the control price and hence between 117.70 and 96.30 euro </div>			- 3.5% (108.08 euro)
		- 10% (90.00 euro)	- 10% (96.30 euro)			
		▲		▲		
		Opening price = 107 euro = control price		Reference price = 112 euro = control price		

Note: in accordance with regulations, Borsa Italiana may change price variation limits for the automatic control of the regularity of trading; an overshoot of the price variation limits causes a temporary suspension of trading.



Type of orders

The introduction of the closing auction was accompanied by the creation of a new trading order identified by a timing parameter restricting its execution to just the closing auction. These orders only become effective (and acquire time priority) during the closing auction, but can be entered (even if not visible on the order book) from the beginning of the continuous trading phase for each specified financial instrument.

Adoption of the EuroBIt market model also led to a change in the management of orders with hidden quantities (iceberg orders). Iceberg orders are orders where quantities are only partially displayed: the order has a quantity visible to the market and a quantity (equal to at least the visible quantity) that remains hidden; until the order is fully executed, each time the visible quantity is traded, another slice of the order (equal in size to the quantity previously visible) becomes visible. With a view to simplifying the management of iceberg orders, and considering the elimination of minimum trading lots with effect from 14 January 2002, a change has been introduced fixing the minimum exposure in terms of value, and no longer in terms of number of shares.

Lastly, the default value of the expiry of “good-till-date” trading orders has been set at 90 calendar days: failing specific indication on the part of the authorised trading intermediary, the system automatically takes the date of entry plus 90 calendar days as the date of maturity.

A second important milestone in the process of adaptation to the EuroBIt market model was achieved on 14 January 2002, with the elimination of minimum trading lots in the MTA, in the After Hours Market and in the Mercato Ristretto (since it was set up, the Nuovo Mercato has operated without minimum trading lots). The possibility to trade any quantity of shares not only corresponds to the requirements for standardisation of trading procedures, but also offers potential advantages, such as:

- increased flexibility in investment decisions on the part of end investors - whether individual or professional investors - favouring the negotiation of securities in value;
- end to the need for frequent adjustments to the structure of minimum lots during interventions on capital (increases, decreases, splits, mergers) and variations in shares prices, at the same time avoiding the formation of odd lots.

Completing the adoption of the EuroBIt market model is the introduction of random closing of auctions and, for the blue-chip and Nuovo Mercato securities, the adoption of the closing auction price as reference price. These changes are scheduled to be introduced during the second half of 2002.

- Random closing of auctions means that the exact time of conclusion of the pre-auction phase of all the day’s auctions (opening, closing and intraday auctions activated as a result of volatility interruptions) is not known *ex ante*: the possibility to enter orders (and hence to revise the theoretical auction price) is over in a second - randomly defined by a special calculation algorithm - within the time span of the last minute of the pre-auction phase. This enhances the significance and regularity of the price formation process during the auction phase.
- Adjustment of the value of the reference price for blue-chip and Nuovo Mercato securities to the closing auction price follows the significance of the closing auction price which can thus become the representative price for the closing of the trading session. This

innovation facilitates parties wishing to trade at the closing price, especially if such price is used to evaluate investment portfolios.

THE STOCK INDICES OF THE MTA AND THE NUOVO MERCATO

During 2001 some innovations were introduced involving the management of the MIB30 index and the creation of new indices for information purposes relating to the STAR segment and the Nuovo Mercato.

- With reference to the **MIB30 index**, the level of the “alpha” parameter, which confirms whether or not a share is suitable for inclusion in the index, has been changed. The basket of the MIB30 index is normally revised twice a year (in the months of March and September), through selection of the securities based on the indicator of liquidity and capitalisation (ILC indicator) for each individual share during the previous six solar months. For each share so selected the “alpha” ratio is calculated - obtained from the ratio between average daily capitalisation and average daily trading volume - and shares showing a value above a certain level are excluded. Since empirical experience has shown that the shares included in the MIB30 have an alpha that is strictly below the value previously established at 10,000, the parameter has been reduced to 1,500. The lowering of the

Foreign shares, meeting ILC and alpha requirements, can be included in the basket of the MIB30 and MIDEX indices

threshold also makes it possible to ascribe greater importance to the level of liquidity of the shares, a tendency underway at international level as a result of the gradual move from capitalisation indices to free float indices.

Moreover, in order to enhance the level of representation of the MIB30 and MIDEX indices, the possibility to include foreign shares in their composition has been introduced. Inclusion is subject to observance of the ILC and “alpha” requirements provided for all shares and to explicit undertaking as regards compliance with information obligations required by Borsa Italiana such as, for example, the timing for distribution of dividends. In the case of participation of a share governed by foreign law in the MIB30 and MIDEX indices, the same share is also included in the information MIBTEL and MIB indices.

- Following the creation of the STAR segment, it became appropriate to define a **MIB STAR index** representing the shares belonging to the new segment of the MTA. The new index, reconstructed with effect from 29 December 2000, is calculated once a day at the end of the trading session based on the official price of all its components.
- The dissolution of the Euro.NM circuit on 31 December 2000 marked the end of the Deutsche Börse’s assignment to calculate and circulate the indices of the Belgian, French, German, Italian and Dutch “new markets”. From 1 January 2001, Borsa Italiana distributes **Nuovo Mercato information indices**, which use the same calculation methodology provided for the corresponding indices of the MTA: the NUMTEL is an index of the MIBTEL type, calculated every minute based on the prices of the last contracts concluded; the NUMEX-r is an index of the MIB-r type, calculated once each day at the end of the trading session based on the reference price; the NUMEX is an index of the MIB type, calculated once each day based on the official prices. Distributed during the evening market is the NUMTEL-s index, which adopts the structure of the NUMTEL and is distributed only for information purposes.



Considering the higher volatility of the shares of the Nuovo Mercato compared to those of the MTA, the weights of the shares making up the basket are revised on a quarterly rather than on a six-monthly basis as in the case of MTA indices.

OTHER INNOVATIONS REGARDING THE MANAGEMENT OF THE STOCK MARKET

During the course of 2001, additional changes were introduced within the context of the stock markets organised and managed by Borsa Italiana concerning the quality of the price formation process, the relationship between the issuers and the market and the guarantee of the quality of instruments listed.

- **Specialist for closed-end fund units.** Admission to listing of closed-end fund units has been made conditional upon the appointment of a specialist who undertakes to support liquidity, for a minimum period of time and with exposure obligations established for each instrument in the admission provision.
- **Restraint from admission of market orders on the first day of trading.** In order to avoid anomalous price trend situations, the possibility to enter orders without price limit on the first day of trading has been eliminated. The sole presence of limit orders ensures the active participation of all orders to the price formation process and the presence of investors who are more aware of the price at which they can conclude contracts.
- **Dates for coupon detachment and for extraordinary share capital operations.** From January 2002 Borsa Italiana extended the calendar of dates available for the detachment of coupons and for extraordinary share capital operations which causes the detachment of a right. Issuers are now allowed to carry out these operations the first trading day of each week. For companies whose shares belong to the MIB30 or to the MIDEX, or representing the underlying of options negotiated on the equity derivatives market, dividends can be paid only the first trading day after the third Friday of each month.
- **Lock-up rules for the shareholders of companies on the Nuovo Mercato.** The shareholders whose interests exceed 2% of ordinary capital, the founder shareholders, the directors and managers undertake not to perform operations involving a quantity equal to at least 80% of the ordinary shares of the company held by them at the date of submitting the request. This restriction on the availability of the shares is valid for one year (extended to two years for “start-up” companies, in which case, for the first year the restriction is placed on 100% of shares held). In 2001 Borsa Italiana extended this restriction, reserving the right to also subject to lock-up obligation shareholders having acquired this status more than twelve months prior to the request for admission to listing, wherever a controlling interest is concerned. At the same time, with a view to encouraging market efficiency, a departure was introduced in favour of securities lending, provided they do not imply selling the interest in the company. The maximum quantity of shares on which the departure can be granted is equal to 10% of the restricted shares (20% for the first year of validity of the lock-up in the case of start-up).
- **Documentation to be attached to applications for admission to listing.** In order to guarantee the presence of up-to-date and reliable documents and, at the same time, to

The lock-up is aimed at impeding the selling of participation by relevant investors for the management of the company after the listing of the same

facilitate compliance on the part of issuers, some changes have been introduced to the rules regarding documentation to be attached to applications for admission to listing: in some cases, instructions have been added, while in others, previously existing requirements have been formalised or specified.

- ◆ The following steps have been taken to ensure that investigations for admission to listing are based on up-to-date documentation: introduction of the requirement that between the close of the last attached balance sheet and the admission decision no more than 15 months must have passed and explication of the request to attach quarterly data if between the admission decision and the close of the quarter more than 45 days have passed.
- ◆ It is now official practice to request, as part of the documentation to be attached to the application for admission to listing, a report designed to evaluate the competitive positioning of the issuer in the main sectors of operation based on outlines prepared by Borsa Italiana (Q-MAT). Standardisation of the requested documentation makes it possible to expedite the investigation for admission to listing, at the same time facilitating the issuer through the use of predefined models.
- ◆ To ensure a sufficient level of close examination and completeness of the document supporting the valuation of the company, the valuation methods to be used and the main aspects to be taken into consideration are explained. In particular, the detail must show the working out of the method for discounting the economic and financial flows and the market multiples method.
- ◆ The sponsor must prepare a financial research report on the company which, if not available at the time of submitting the application for admission, must be furnished at least five days prior to the admission decision.
- **Rules concerning the sponsor.** With a view to enhancing the role of the sponsor, Borsa Italiana has established that, in the case of an offer for sale or subscription through syndicate, the sponsor would assume the role of lead manager for the public offering or institutional placement. To properly manage potential conflicts of interest involving the sponsor, Borsa Italiana can request the appointment of a second sponsor (co-sponsor) wherever shareholding and/or lending relationships exist between the sponsor and issuer.
- **Adjustment criteria for extraordinary dividends.** During the course of 2001 Borsa Italiana launched a process of consultation with intermediaries in order to clarify, and

Borsa Italiana distinction between ordinary and extraordinary dividend is based on the dimension and regularity of the payment

where necessary to integrate, the rules for adjusting operating indices and derivatives instruments, with special reference to the cases connected with the distribution of extraordinary dividends. The consultation process ended with the adoption on the part of Borsa Italiana of a distinction between ordinary dividend and extraordinary dividend based on a dual criterion, of timing and of quantity. As regards the timing criterion, the dividend is considered

ordinary if the payment is systematic: the payment has been resolved by the shareholders' meeting to approve the financial statements; any partial payments refer to a distribution policy providing for partial payments on dividends explicitly communicated by the company. According to the quantitative criterion, ordinary dividends are considered to be those where the amount does not exceed 8% of the share's average official price during the five trading days preceding the date on which the company's Board of Directors approves



the draft financial statements and formulates the proposal for distribution of the dividend (in the case of distribution of partial payments, the percentage must take into account the number of distributions carried out during the period). The dividends that do not observe one or both these criteria are considered extraordinary and payment of same requires an adjustment through the application of an adjustment coefficient in the time series of the share prices and in the strike price of the options: in the case of the payment not being systematic, the adjustment equals the full amount of the dividend; in the case of the amount of the dividend being in excess of that defined as per the quantitative criterion, the adjustment is calculated based on the excess portion.

THE COVERED WARRANTS MARKET (MCW)

Since the start of trading in June 1998, covered warrants have seen a constant and substantial growth in terms of number, type of issues and turnover. During the course of the years, Borsa Italiana has adapted the regulatory and operational framework to the specific characteristics of supply and demand for these financial instruments. The most important innovations were introduced, on 28 February 2000, with the creation of the Covered Warrants Market as autonomous market of the Stock Exchange market and, on 24 July 2000, with the adoption of a trading platform dedicated to covered warrants.

The level of internationalisation characterising covered warrants as regards issuers and underlying instruments made it necessary to standardise some of the requisites for admission in order to render the issues more easily comparable and, by so doing, to increase the competition between issuers, to the benefit of the end investors and hence of the market's further growth (table 5).

In 2001, Borsa Italiana's commitment was focused on development of the market at international level with a view to enhancing the official list by attracting issuers and

TABLE 5 - COVERED WARRANTS: STANDARDISED TECHNICAL CHARACTERISTICS

Technical characteristic	Underlying asset		
	Shares listed in Borsa Italiana markets	Indices managed by Borsa Italiana	Other underlying assets
Par (or multiple) ⁽¹⁾	0.1	0.0001	Not standardised
Settlement price	Reference price of the day prior to expiry date	Value of the index calculated based on the opening prices of the financial instruments comprising it on the expiry date	Not standardised, while nevertheless expressing a significant quantity of volumes traded on the underlying asset
	All underlying assets		
Exercise of option	Automatic exercise at expiry date in cases where the option contained in the covered warrant is in-the-money. The issuer undertakes to pay the positive difference to the investor, failing specific waiver on the part of same.		

(1) The par (or multiple) indicates the number of underlying assets for each covered warrant.

intermediaries present also on other foreign markets. This is the direction taken by the amendment to article 62 of Consob regulation 11971, which facilitates the admission to listing of covered warrants issued under a programme, simplifying and expediting listing procedures for international issuers: the innovations particularly concern the possibility to admit covered warrants issued under a programme and the consequent reduction in the time taken by Borsa Italiana to review the application for admission of the individual financial instruments. A further concession in favour of issuers concerns the possibility to rationalise issue policies and to execute pan-European issues characterised by a higher level of standardisation. Through dual listing of issues already listed on other foreign regulated markets, the Covered Warrants Market can draw advantages in terms of number and range of listed instruments, with a leverage effect on the participation in the market of intermediaries of higher international standing.

The elimination of standardisation as regards the covered warrants expiry date, which previously coincided with the last working day of the week, fits into this perspective. This technical characteristic is not in fact an admission requirement of the other main foreign markets and to retain it would have implied a reduction in the number of instruments acceptable in dual listing in the MCW and hence a limitation on the market's expansion opportunities. The protection of investors is in any case guaranteed: any oversights or uncertainties regarding the expiry date are overcome by the issuer's obligation to automatically acknowledge at maturity any positive price differential in favour of the investor.

Borsa Italiana's strategy for expansion has brought to the market a wide range of instruments able to satisfy all the different investment and trading needs. At the same time, in order to make the covered warrants official list more informative and easily consultable, a segmentation has been introduced which, whilst not presenting any difference in trading procedures, divides the instruments into homogeneous categories by type of structure. The Covered Warrants Market is organised into the following segments:

- plain vanilla segment: includes covered warrants consisting in a call or a put option with a non-zero strike;
- benchmark segment: includes covered warrants consisting in a call option with a zero strike;
- certificates segment: includes covered warrants consisting in a call option with synthetic indices constructed by the same issuer as the underlying;
- structured/exotic segment: includes covered warrants that are combinations of call and put options or that incorporate exotic options.

During the course of 2001 other more strictly operational changes were introduced that are important for the purposes of management of orders on the part of the market makers and regularity of the price formation process.

- The introduction of the double quotation function enables market makers to simultaneously enter a bid and an ask order on the financial instruments on which they operate as market makers. This functionality helps to enhance the efficiency of the market makers' operations thanks to the speed with which the quotations can be entered and updated.
- In order to facilitate the automatic control of the regularity of trading in cases of prolonged absence of trades, Borsa Italiana reserves the possibility to use as guide price for the price



discovery process a theoretical value determined based on the financial instrument's market prices, considering the quotations entered by the market maker intermediaries.

- Still with a view to facilitating the price formation process, at the beginning of 2002 a regulatory change was introduced to link the price fluctuation parameters to the level of the control prices. The new structure of price variation limits was also extended to the evening market.

THE FIXED-INCOME MARKETS: MOT AND EUROMOT

During the course of 2001, the fixed-income markets did not require any changes to the microstructure models or to the admission requirements for instruments and intermediaries; only some changes were introduced for the purpose of further rationalising the operational and regulatory framework.

From a regulatory standpoint, Borsa Italiana introduced specific rules assigning to the issuers of bond the possibility to request exclusion of their issues from trading. The inclusion of this provision follows the presence of bonds with extremely low liquidity and residual amounts, where trading is limited and the price formation process has little significance. In any case, due to the need to protect investors, the request for exclusion from trading is conditional upon the coexistence of the following conditions:

- issuer's commitment to repurchase the outstanding bonds at the bondholders' request;
- lack of trades for a period of at least 18 months;
- residual amount of loan less than 2.5 million euro or equivalent;
- number of holders less than 200 for bonds issued by parties other than banks.

From an operational standpoint specific procedures were defined for the calculation of interest accrued on the bonds traded.

For the securities traded in the EuroMOT segment, the applicable calculation convention, which is communicated in the Stock Exchange notice announcing the start of trading date, follows international practice providing for:

- as regards financial instruments denominated in euro: fixed-rate securities, the actual/actual convention with interest rate calculated on an annual basis; variable-rate securities, the actual/actual convention with rate of interest calculated on an annual basis or the actual/360 convention;
- as regards financial instruments denominated in a currency other than euro, any one of the conventions manageable by the trade-checking service: actual/actual, actual/360, 30E/360 and actual/365.

For the securities traded in the MOT segment, the rules differ according to whether the financial instruments were issued under Italian regulations or foreign regulations. As regards the former only the actual/actual convention is envisaged with interest rate calculated on a period basis, in accordance with the practice adopted by Italian issuers. For securities that come under foreign regulations, the same criteria established for the EuroMOT are adopted, the convention used for each individual security being specified in the start of trading notice.

THE EQUITY DERIVATIVES MARKET (IDEM)

For the equity derivatives market, 2001 was a year of preparation for important innovations due to become effective in the course of 2002.

The planned migration of the equity derivatives market to a new trading platform has involved a substantial upgrading of the technological infrastructure whereby, owing to the utilisation of the best technology currently available, it is possible to provide the trading system with a capacity up to six times greater than the present one. The new platform will make it possible to adopt the functionalities most suited to the market's expansion requirements, for both the

The migration of the IDEM to a more state-of-the-art, efficient and powerful trading platform is scheduled for the early months of 2002

service model and the market model perspective.

The new service model is a client/server model where access to the trading system on the part of the intermediaries participating in the market is based on the "turnkey" concept: Borsa Italiana provides all the technological infrastructure necessary considerably simplifying the procedures for start-up and maintenance of the market access systems. With the new service, the connection to the market moves from the central system to the peripheral systems at the offices of each intermediary. There are notable benefits in terms of reliability and security of the trading system and flexibility of access for the intermediaries:

- two lines of communication and network equipment in full backup configuration are installed at the offices of each member intermediary: in the event of a technical failure, the system guarantees automatic and simultaneous changeover to the backup configuration, which assures the same high performance of the primary access modes;
- the connection to the market takes place through the network gateways, installed at the premises of the member intermediary, to which the intermediary can connect using either the current trading workstations (click stations) or ordinary personal computers.

This new context implies an extension of the responsibility of Borsa Italiana, which guarantees the complete supply of all equipment needed to connect the intermediaries to the market, currently fully borne by the latter in terms of both responsibility and costs.

Moreover, some changes to the IDEM market model will be introduced with the new trading platform: albeit without modifying its general principles - order driven microstructure with the presence, for some derivatives instruments, of market makers to sustain the liquidity of the market -, there will be changes to some aspects regarding the market makers, the management of stop orders and the functions for order entry on the part of the market makers (mass quotation) and of the other member intermediaries (block orders).

- The **market makers**, through their activity of displaying continuous bids and asks on the market, perform an important role with regard to increasing the liquidity of the market and the efficiency of the price formation process. The presence of market maker intermediaries is required for options on the MIB30 index (MIBO), the MiniFIB and the options on single shares (stock options). The main innovation concerns the definition of two types of market maker: the Primary Market Makers (PMMs), who undertake to continuously support the liquidity of the instruments during the trading session and the Market Makers (MMs), who undertake to supply additional liquidity to the market in



response to requests for quotes coming from other intermediaries. While for the MiniFIB only the presence of the PMMs is envisaged, for the other derivatives both types of market maker intermediaries will be present. According to the category to which they belong, different obligations are defined in terms of: number of stock option contracts to be quoted; minimum size of quotations for index and stock options; order re-establishment times in case of execution; request for quote response times and length of time orders remain on the book following the requests (for the MMs); number of expiry dates and number of series to be quoted for MIBO and stock options.

- **Stop orders** are orders that are only activated when a determined market condition occurs (trigger condition) as defined by the intermediary at the time of entering the order. With the new trading platform it will be possible to change the operating procedures for this type of strategic order.
 - ✦ Stop orders will be managed at central and no longer at peripheral level, with a consequent notable increase in efficiency in terms of order activation timing and security upon the trigger condition occurring.
 - ✦ The trigger condition can be more flexibly defined. First of all, the reference price against which the trigger price is to be compared for the purpose of activating the stop order can be a bid, ask or last price. The comparison condition may also be set up in terms of “greater than or equal to” or “less than or equal to”. Another important innovation, which will enhance the order’s strategic use potential is the possibility to tie the trigger condition to instruments other than those intended to be actually traded. In fact, for the stop order it is necessary to identify two series: the “stop series”, which defines the instruments on which to verify the occurrence of the trigger condition; the “convert to series”, which defines the instruments that will become the object of the order shown on the order book once the stop order has been activated.
- The **mass quotation** is the functionality allowing market makers to send to the market a certain number of quotations at the same time. The new trading platform will make it possible to progress from a function that allows entry of single quotations or double quotations to a function that will allow simultaneous transmission to the market of up to 200 quotations in a single transaction.
- The **block order** is a functionality enabling non-market maker intermediaries to enter more than one order at the same time. This new type of order will enable member intermediaries to enter up to 100 orders simultaneously in a single transaction.

With the new trading platform it will be possible to handle on a daily basis up to 30 million orders and 4.2 million contracts, on a number of up to 15,000 series