

PERFORMANCE AND PROTECTION

Corporate and Government Bonds





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Corporate and Government Bonds

Foreword

Over the past few years, Bonds have proved to be the financial instruments preferred by Italian investors, as shown by their increasing success in terms of both trades and turnover executed on the MOT market.

Protection and Performance

Bonds are debt securities, issued by public entities or private companies to finance their activities, which guarantee that the investor will receive full redemption of the capital invested plus payment of interest. Given the issuer's solvency capacity, investors thus have the possibility to invest their accumulated savings in financial assets without running the risk of losing their capital, obtaining a yield in keeping with the issuer's creditworthiness.

Flexibility

The broad spectrum of bonds available on the market allows investors to choose from a wide range of financial instruments, according to their respective risk/yield objectives. Investors can therefore adopt a multitude of investment strategies such as, for example, diversification through the creation of a bond portfolio with different maturities, credit quality or type of coupon flow, or the so-called "buy-and-hold" strategy, whereby the investment is held until maturity in order to obtain foreseeable income flows. It is also possible to establish short-term trading strategies so as to take advantage of the trend in the interest-rate curve by exploiting the greater sensitivity of longer term instruments.

Stability

The protection of invested capital means that the Bonds tend to be less sensitive to the volatility of the financial markets compared to other financial instruments. This enables investors to benefit from some degree of stability as regards the value of their investment.

Categories: key elements and investment strategies

Bonds can essentially be divided into the following categories according to the type of issuer:

Government Securities, Corporate Bonds, other securities

Government Securities

What are they?

Government Securities are instruments issued by a national government to fund its debt requirements, meet the country's needs and finance its institutional activities. The Government Securities of numerous European Union countries (Italian, German, French, Spanish, Greek, Austrian and Swedish) are traded in the MOT. These may, in particular, include the most liquid securities which from time to time cause a revision of the various yield curves in Italy, Germany and France.

The Italian securities are issued by the Ministry for the Economy and Finance and, since they are guaranteed by the Italian State, are considered a very low insolvency risk and pay lower yields compared to the more risky instruments.

The main types of Italian Government Securities currently in circulation are: ordinary treasury bills (BOT), treasury credit certificates (CCT), long-term treasury bonds (BTP), zero coupon treasury certificates (CTZ) and long-term inflation indexed treasury bonds (BTPi).

| Security | Duration | Remuneration | Minimum Denomination | Repayment |
|----------|---|---|----------------------|--------------------|
| BOT | 3, 6 and 12 months (or flexible from 1 to 12 months) | <i>Issue discount</i> : there is no coupon, but the payment of interest is implied by the difference between the nominal amount and the issue price | € 1.000 | Bullet at maturity |
| CTZ | 24 months | <i>Issue discount</i> : there is no coupon, but the payment of interest is implied by the difference between the nominal amount and the issue price | € 1.000 | Bullet at maturity |
| BTP | 3, 5, 10, 15 and 30 years | <i>Fixed semi-annual coupons, issue discount</i> | € 1.000 | Bullet at maturity |
| BTPi | 5, 10, 15 and 30 years | <i>Real semi-annual coupons, issue discount and revaluation of capital at maturity</i> | € 1.000 | Bullet at maturity |
| CCT | 7 years | <i>Floating semi-annual coupons, issue discount</i> | € 1.000 | Bullet at maturity |



Key elements

Government securities guarantee:

- **a high level of trustworthiness:** investors enjoy a strong guarantee as regards the solvability of the issuer, since the latter is represented by the Country actually issuing the securities. In fact, the trustworthiness regarding the fulfilment of commitments undertaken by the State will only cease to apply in the case of default of the same.
- **regularity of placements:** issues of government securities occur at regular intervals according to programmes established by individual national governments in order to meet the Country's requirements.
- **diverse yield possibilities:** via access to these instruments it is possible, for the more experienced investors, to "gamble" on the future slope of a country's yield curve, or on the trend in the differential between the yield rates of similar securities belonging to the curves of different countries.
- **high level of liquidity:** the structural simplicity and large quantities issued help to make these instruments highly liquidable, as guaranteed by numerous bids and asks allowing investors to trade the securities in question at any time.

“Bonds allow investors to combine protection with performance, flexibility with stability”

“Corporate Bonds enable investors to diversify their portfolio benefiting from higher yields compared to Government Securities with similar maturity”

Corporate Bond

What are they?

Corporate Bonds are bonds issued by private entities, primarily banks and industrial companies, and feature a higher yield compared to Government Securities with similar duration.

This category includes a wide range of bonds: alongside the more plain vanilla, such as zero-coupon bonds (which do not provide for the payment of periodic coupons, but pay interest implied by the difference between the bond's

nominal amount and issue price), fixed-rate bonds, floating-rate or inflation-indexed bonds, are the structured bonds, whose redemption or remuneration is tied to the performance of other financial assets (mainly including interest rates, indices, shares, funds and commodities) and subordinated bonds, which offer higher yields with respect to non-subordinated bonds having the same issuer, since redemption is subject to the prior satisfaction of other creditors in case of the issuer's default.

THE MAIN CORPORATE BONDS ON THE MARKET

FIAT • **Enel** • **Eni** • **Telecom Italia** • **A2A** • **Finmeccanica**
General Electric • **PEUGEOT** • **BMW** • **Edison** • **DEUTSCHE TELEKOM**
Edf Energy • **IBM Corporation** • **Daimler** • **France Telecom** • **Renault**
Rolls-Royce • **Lvmh Moet Hennessy Louis Vuitton** • **Carrefour**
Deutsche Bahn • **Groupe Auchan**



Key elements

With Corporate Bonds it is possible to:

- **benefit from a higher yield compared to Government Securities with similar maturity since they expose the investor to the issuer's solvency risk:** the bond yield increases in proportion to the risk of bankruptcy on the part of the issuer. An issuer's credit quality, or reliability that the issuer will meet commitments, is measured by the rating that is periodically revised by independent specialised agencies.
- **choose between different structures:** according to the investor's risk profile he can invest in simple instruments or structured bonds which are more complex and carry a higher risk but are potentially capable of offering attractive additional yields based on the trend in the chosen indexation parameter.
- **diversify between geographical areas and industrial sectors:** most of the corporate bond offering is issued by Italian and foreign companies operating in a variety of industrial sectors. Investors can therefore expand their investment boundaries, by transacting in currencies other than their own where significant appreciations are expected in various industrial sectors.

Investment strategies

In view of their diverse nature, corporate bonds can fit into any investment strategy:

- **short-term trading:** the more plain vanilla bonds enjoy a strong liquidity which makes them suitable also for trading logics that take advantage of interest-rate curve movements.
- **long-term investment:** structured bonds, which do not enjoy very high liquidity, are more suitable for holding until the security's maturity to take advantage of any additional yields and preserve invested capital.



Other securities

Supranational Securities

These are bonds issued by international institutions and entities that cannot be identified with a single country since they involve the participation of several sovereign states. The main feature of such securities concerns the default risk of the issuers in question which is normally limited, thereby guaranteeing a high degree of trustworthiness. In view of this characteristic they are more similar to Government Securities than corporate bonds, which makes them even more attractive as uncertainty on the stock markets grows.

On the other hand, those investing in securities of this kind normally have a greater propensity towards an investment that is able to guarantee their capital, albeit to the detriment of their pursuit of high yields. The bonds may be expressed in strong currencies, ranging from the US Dollar to the Japanese Yen, the Euro to the British Pound, or in the currencies of emerging countries.

Although to invest in instruments denominated in other currencies offers the possibility to pursue additional profits, at the same time it represents a further risk for the investor (particularly as regards securities denominated in the currency of an emerging country).

The main issuers present on the MOT are the EIB (European Investment Bank) and the Council of Europe Development Bank.

ABS

Asset backed securities (or ABSs) are financial instruments, issued under securitisation transactions. In brief, a company holding a pool of receivables sells the same to another specifically created company (the vehicle or SPV). The vehicle will, in turn, issue bonds (ABSs) with a view to placing them with end investors in order to pay for the purchase of the receivables in question. Lastly, the assigned receivables are pledged as collateral for the payment of the bonds issued. As with normal bonds, they pay the holder periodic coupons at set payments dates for an amount calculated based on fixed or floating interest rates. The particular feature which distinguishes ABSs from ordinary bonds lies in the strict correlation that exists between payment of coupons/redemption of the bonds at maturity and the sums collected from the receivables in portfolio. In order to reduce the risk of partial or total failure to repay the ABSs, in the event that the receivables supporting the transaction might not be collected, as a rule the amount of the receivables assigned and pledged as collateral is often higher than the nominal value of the bonds issued. Borsa Italiana has imposed a series of minimum requirements that the ABSs must satisfy in order to be admitted to listing. These requirements basically refer to the *residual nominal amount* (equal to at least 50 million Euro) and the *minimum rating* required, which must be between "AAA" and "BBB-" assigned by the main rating agencies (investment grade status).

The Borsa Italiana bond markets: MOT and ExtraMOT

In order to ensure easy access to the extensive domestic and international bond market, Borsa Italiana manages two markets for the electronic trading of bonds and Government Securities:

- **MOT**, the regulated market dedicated to the trading of Italian and foreign Government Securities, corporate bonds for the domestic and international market, supranational securities and ABSs, European leader in terms of turnover and trades.
- **ExtraMOT**, the new exchange regulated market for the corporate bonds of Italian and foreign issuers already admitted to trading on other regulated markets of the European Union.

To facilitate investors in selecting their bonds the MOT market has been divided by bond category into three segments:

1. Italian Government Securities
2. Debt securities (corporate bonds for the domestic market)
3. Eurobonds, ABSs, securities of foreign issuers and other debt securities, also in currencies other than Euro settled via Euroclear and Clearstream Banking Luxembourg.

Microstructure

Liquidity

In order to ensure the maximum liquidity of bonds traded on the Borsa Italiana circuits, in both markets an "**order driven**" model is adopted whereby anyone (whether an intermediary's end client or an operator trading for own account) can enter buy and sell orders for the instrument in question thereby ensuring a transparent and efficient price formation process. The presence of specialists who, operating for own account, support the liquidity of the instruments traded, is also provided for.

The **specialists** are required to display buy and sell orders on a continuous basis, based on minimum quantities determined by Borsa Italiana.

Only as regards the MOT market, the specialist is also required to display buy and sell orders at prices that must not exceed above a set spread.

As regards the ExtraMOT market, the specialist's presence is mandatory for all financial instruments for which such operator has requested admission to trading. Borsa Italiana monitors the observance of commitments on an ongoing basis.

Lastly, a **wide network of participants** who help to support the market's liquidity have direct or interconnected access to both markets.



Trading

Trading in both markets takes place via **auction** and subsequently, up to the end of the trading day, via **continuous trading**. During the auction phase trades are concluded at a theoretical price which maximises the quantity traded. During the continuous trading phase, trades are concluded via the automatic matching of buy and sell orders entered, ranked according to the price/time criterion. Orders may be entered with or without price limit and other conditions may be indicated such as, *inter alia*, "good till time", "good till cancelled" and "good only in auction".

In order to ensure the regular course of trading, price control mechanisms are provided as regards the orders entered and the prices of trades. No orders may in fact be entered whose prices exceed excessively with respect to the reference price and a validation process is provided for the prices of trades, that also takes account of the variation with respect to the price of the previous trade concluded. Any attempt to execute orders that do not comply with such limits triggers volatility auctions.

Trades are settled automatically, via **Monte Titoli S.p.A.** for the first two segments of the MOT market and via **Euroclear** and **Clearstream Banking Luxembourg** for the third segment of the MOT market and for the ExtraMOT market.

Borsa Italiana carries out a constant monitoring of trading with the possibility, in consideration of particular market trends, to interrupt continuous trading and, at the same time, resume an auction phase, with a view to re-establishing an orderly course of trading or, in the more serious cases, to suspend the trading of instruments or the activity of intermediaries.

Information transparency

Borsa Italiana guarantees the real-time dissemination of all information required for trading purposes. Moreover, its website contains an entire section dedicated to Bonds, accessible from the homepage via the "Quotes" and "Bonds" options. The website provides the latest market news, principal bond records, prices and, for the MOT market, prospectuses and monthly statistics. Moreover, it is also possible to download the new Borsa Italiana newsletter "Inside Markets" setting out trading ideas and analyses relating to the bond markets.

Furthermore, the section dedicated to the ExtraMOT market offers the possibility to download, for each security traded starting from the first day of trading, a term sheet summarising in a clear and easily consultable manner the main features of each security traded, trading procedures and hours.



Borsa Italiana

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