ETFplus Functionality: Cross Orders, Block Trade Facilities and Request For Quotes

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1.0 Overview

Following the migration of Borsa Italiana's cash markets onto the Millennium Exchange platform in 2009, Cross Orders, Block Trade Facilities (BTFs) have since become an integral part of members trading activity. RFQ has also been added from the beginning of 2017.

Cross Orders and BTFs provide members with the possibility to execute a bilateral agreed/identified transaction, on a fully MiFID II compliant regulated market. This provides members with the option to execute contracts with specified counterparties, whilst also offering flexibility in terms of the size and transaction price.

Contract price and value are two factors that differentiate Cross Orders and BTFs. A Cross Order may be executed regardless of the monetary value, as there is no minimum monetary value required, but the transaction price must fall within the best weighted average bid-ask range in the market (bounds included), according to the incoming size of the Cross Order. A BTF may only be executed for an amount above a minimum monetary value (according to MIFID II Large in Scale (LIS) thresholds), although the price may differ from the markets best bid-ask by a predefined percentage, defined by Borsa Italiana and set at group instrument level.

Borsa Italiana manages Cross Orders and BTFs as either "Internal" or "Committed". "Internal" Cross Orders/BTFs are those transactions which are completed within a single intermediary, whereas "Committed" Cross Orders/BTFs are those transactions negotiated or identified by two different intermediaries.

- "Internal" Cross Order/BTF – A single intermediary will enter both sides of the trade and subject to the parameters being verified, the system will match the two legs, leading to the execution of the contract, without any impact on the order book

- "Committed" Cross Oder/BTF – Two different counterparties will enter the two sides of the Cross Order, which are associated by the system through the same ID (i.e. the CrossID for Cross Orders). Subject to the

parameters being verified, the system will match the two trades, leading to the execution of the contract, without any impact on the order book

The RFQ functionality enables all members a fast and efficient way to find on-exchange (but off-book) counterparties for size, that otherwise may have been executed OTC.

2.0 Benefits

2.1 Cross Orders and BTFs

Cross Orders and BTFs are important functionalities that extend Borsa Italiana's ETFplus services to benefit members and in turn, the wider market.

Both functionalities combine the benefits of negotiation privacy and flexibility, typical of a bilateral contract, with the benefits of an on-exchange executed transaction, as they:

- Guarantee the certainty of execution at the price and quantity agreed with the counterparty

- Function as contracts executed on-exchange (but off-book)

- Are fully MIFID II compliant, meeting pre[1] and post trade transparency requirements. Therefore, other than executing the trade via a Cross Orders/BTF, there are no further reporting requirements, such as an Approved Publication Agreement (APA)

- Have no counterparty risk as Cassa di Compensazione E Garanzia (CC&G) guarantees

- Enable the automatic fulfilment of Trade Reporting requirements

- Accounted to calculate the whole volumes on the relevant instruments

- Are subject to the transaction fees applicable for on-book contracts, which are particularly favourable for large size trades

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[1] Pre trade transparency requirements are not required under the following waivers:
- Cross Orders for ETFs under the Negotiated Transactions waiver
- Cross Orders for illiquid ETCs/ETNs under the illiquid waiver
- BTFs for ETFs and ETC/ETNs under the LIS waiver

2.2 RFQs

The RFQ functionality offers members with a range of benefits, which include:

- Consolidation – large transactions benefit from a dedicated on exchange functionality. Borsa Italiana's RFQ trades are reported and consolidated within the exchange volumes

- Efficiency – the RFQ functionality is integrated within Borsa Italiana's trading platform, allowing all members to access it. Active dealers and prospect dealers have the ability to provide quotes to RFQ requests

- Integrated post trading - RFQ trades are automatically cleared and settled in the same way as on-book trades

- No counterparty risk - the CCP (CC&G) covers RFQ trades

- Competitive pricing – institutional clients interested in trading in large-in-scale volumes on exchange, at the best price, can use this functionality to ensure competitive prices as dealers compete against one another

3.0 Changes to Cross Orders and BTFs as a result of MIFIR / MiFID II

In light of MIFIR / MiFID II, Borsa Italiana adapted its rules, trading systems and exchange services, of which, resulted in the following changes to Cross Orders and BTFs.

Cross Orders:

The Cross Order functionality is no longer available for liquid ETCs and ETNs.

The Cross Order functionality for ETFs and illiquid ETCs and ETNs adjusted as follows:

- The price of Cross Orders will now be included within the volume weighted spread available on the order book for the required quantity

- In situations whereby the volume weighted bid or offer price (or both) cannot be determined,

    - The Cross Order will be rejected for liquid ETFs

    - The price will have to be included within a pre-determined percentage deviation[2] from the last trade price (or reference price from the previous day, in case of no trade being executed during the day), for illiquid ETFs, ETCs and ETNs

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Instruments	Percentage deviation from last trade price (or reference price)
Bond ETFs	2%
Equity ETFs and structured non-leveraged ETFs	2.5%
Structured leveraged ETFs, non-leveraged ETFs and double leveraged ETC/ETNs	5%
Tripled leveraged ETC/ETNs	7.5%

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Cross orders will no longer update the following market statistics (but will contribute to quantity statistics for the day):

- Last trade price

- Minimum and maximum trade price for the day

<u>BTFs:</u>

The previous parameter relating to the minimum size (quantity) of BTFs is now expressed in terms of monetary value, with the minimum monetary value set according to the MiFID II LIS thresholds[3] detailed below:

- ETFs: equal to or larger than €1,000,000

- Liquid ETC/ETNs: equal to or larger than €1,000,000

- Illiquid ETC/ETNs: equal to or larger than €900,000

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[3] RTS 1: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2017.087.01.0387.01.ENG&toc=OJ:L:2017:087:TOC&wb48617274=7FF314DA
RTS: 2 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2017.087.01.0229.01.ENG&toc=OJ:L:2017:087:TOC

4.0 Cross Orders and BTF Key Features Summary

Cross Orders and BTFs share some similar characteristics, with the main differentiating factors being that of contract price and value. The below table summarises the key features of Cross Orders and BTFs:

	Cross Orders	**BTFs**
Price parameters	Must fall within the best weighted average bid-ask spread (bounds included)	Must fall within the best bid minus xx% and best ask plus xx% (% set at instrument level and defined by Borsa Italiana)
Monetary value parameters	No requirement	Minimum monetary value as per LIS thresholds (set at group instrument level – see previous page)
"Internal"	Proprietary vs. Agency Agency vs. Agency	
"Committed"	Proprietary vs. Agency Agency vs. Agency Proprietary vs. Proprietary	

5.0 Cross Orders

Cross Orders enable the execution of contracts whereby the price falls within the best visible weighted average bid price and the best visible weighted average ask price range (bounds included), at the time of entry into the trading system.

5.1 Trading characteristics and operating rules

The trading characteristics and operating rules of Cross Orders are as follows:

- The price must be a tick multiple

- The quantity must be a multiple of the minimum trading lot / 1 unit / 1 share

- They may only be admitted during continuous trading (not during auctions)

- They do not contribute to the update of the last traded price (therefore stop or stop limit orders cannot be elected based on a Cross Order)

- They do not contribute to the update of the minimum and maximum trade price for the day

- They do not contribute to the calculation of the reference price and VWAP

- They contribute to statistics updates (i.e. contracts and turnover)
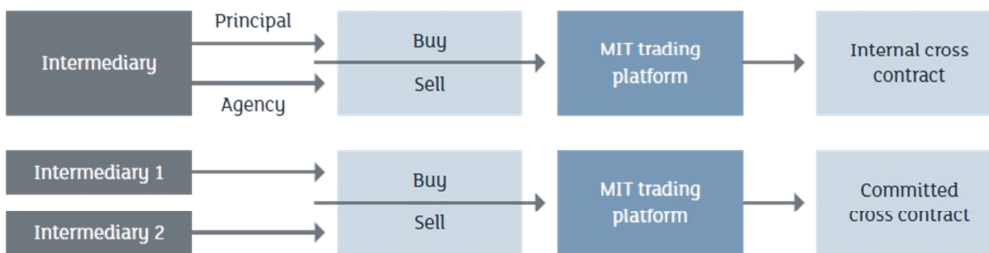
5.2 Trading interface

Internal Cross Order input data example:

- Can be entered as internal and committed

- Price: must be a multiple of the applicable tick and fall within the weighted average best bid-ask range (bounds included)

- Side: select buy and sell together

- Counterparty: there is no need to specify this, as in this case the order is executed internally by the intermediary

- Capacity: all combinations except 'proprietary vs. 'proprietary'

- BTFID/CrossID: there is no need to specify this in an Internal Cross Order

- Order type: Cross

Once the intermediary has entered the Cross order, Borsa Italiana will verify the parameters. If the verification is positive, the contract is then executed and reported through the publication arrangements. If the verification fails, the order is then rejected and the intermediary will have to enter a new Cross Order.

6.0 Block Trade Facilities (BTFs)

BTFs enable the execution of contracts, whereby:

- The price falls within a range that is; the best bid price, minus a defined percentage, and the best ask price, plus the same defined percentage (bounds included), and;

- The monetary value is equal to or greater than a predefined amount

Borsa Italiana defines the percentage variation from the best bid/ask prices. The predefined minimum monetary value is set according to MiFID II LIS thresholds.

For the ETFplus market, the predefined parameters are as follows:

- LIS thresholds:

    - ETFs equal to or larger than €1,000,000

    - Liquid ETC/ETNs equal to or larger than €1,000,000

    - Illiquid ETC/ETNs equal to or larger than € 900,000

- Variation from best bid and ask prices depends on product classification:

    - Bond ETFs: 2%

    - Equity ETFs and structured non-leveraged ETFs: 2.5%

    - Structured leveraged ETFs, Non-leveraged ETFs and double leveraged ETC/ETNs: 5%

    - Tripled leveraged ETC/ETNs: 7.5%

6.1 Trading characteristics and operating rules

The trading characteristics and operating rules of BTFs are as follows:

- They can be entered as internal and committed

- The price must be a tick multiple

- The quantity must be a multiple of the minimum trading lot

- They may only be admitted during continuous trading (not during auctions)

- They do not contribute to the update of the last traded price (therefore stop or stop limit orders cannot be elected based on BTF)

- They do not contribute to the update of the minimum and maximum trade price for the day

- They do not contribute to the calculation of the reference price and VWAP

- They contribute to statistics updates (i.e. contracts and turnover)

6.2 Trading interface

Committed BTF input data example:

- Price: can be outside the best bid-ask (in compliance with defined percentage variation). The price must be a multiple of the applicable tick

- Quantity: must be above the minimum monetary value (LIS thresholds)

- Side: 'sell' for the seller and 'buy' for the buyer

- Counterparty: the seller specifies the memberID of the buyer and vice versa

- Capacity: it may be agency or principal for both counterparties

- BTFID/CrossID: this is an ID agreed by the two counterparties that enables the system to identify the two BTF legs

- Order type: BTF

After receiving the BTF order from the first counterparty, Borsa Italiana will then search for an order on the opposite side with the same parameters (quantity, price and BTFID/CrossID). Upon receipt of the second leg, Borsa Italiana verifies the parameters. If the verification is positive, the contract is then executed and reported to member firms. If the verification fails, the order is then rejected and the intermediaries will have to enter a new BTFs.

7.0 Cross Order and BTF Example

The below diagram highlights an example of the price range in which a Cross Order and a BTF would be verified and accepted by Borsa Italiana.

	Buy				Sell			
Price	0.95	0.975	0.98	1.00	1.01	1.03	1.035	1.060
Amount	400,000	1,200,000	600,000	1,000,000	500,000	1,000,000	1,300,000	800,000
Value	€ 380,00	€1,170,000	€588,000	€1,000,000	€505,000	€1,030,000	€1,345,500	€848,000

1.02

Cross Order:
Price within the best weighted average bid-ask
(bounds included)

BTF:
Price within the range: Bid – X % / Ask + X %
(X % set at group instrument level)
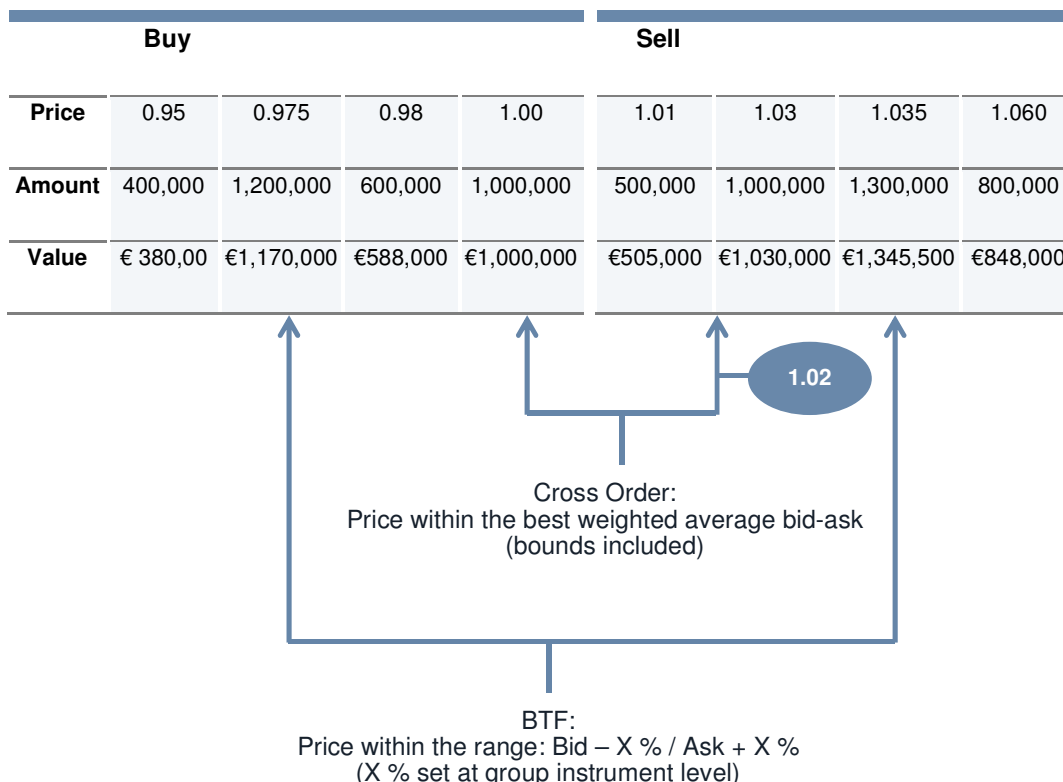
Cross Order – should the price fall within the best weighted bid-ask spread (bounds included), 1.00 (buy) – 1.02 (sell), for an amount of 1,000,000, in the example above, the Cross Order would be verified and accepted. The system would calculate the volume weighted average price (VWAP) for 1,000,000 on the basis that 500,000 would be executed at 1.01 and the remaining 500,000 executed at 1.03, thus the VWAP bound for the sell side being that of 1.02 ((1.01*500,000)+(1.03*500,000)/1,000,000).

BTF – should the price fall within a defined percentage and meet the minimum monetary value, the BTF would be verified and accepted. The above example highlights an Equity ETF, with a defined percentage variation from the best bid-

ask price of 2.5% +/-, therefore a BTF of 0.0975 (buy) and 1.035 (sell), would meet the price variation parameter, thus enabling the BTF to be verified and accepted by Borsa Italiana, providing the BTF also meets the minimum monetary value.

8.0 RFQ

8.1 Negotiation Process

The negation process for the RFQ functionality involves four simple steps:

1. A member can request quotes for large-in-scale sizes by sending an RFQ request to the eligible recipients

2. Recipients (Dealers) who receive the request, can accept the request by sending a quote. The quote can be continuously refreshed

3. To execute the trade, the Requestor can only send instructions to match with the best quote available at the point of matching

4. The negotiation process has a time restriction, therefore should the maximum time be reached, all quotes provider by the Dealer(s) will expire, along with the original RFQ

Example of the negotiation process:
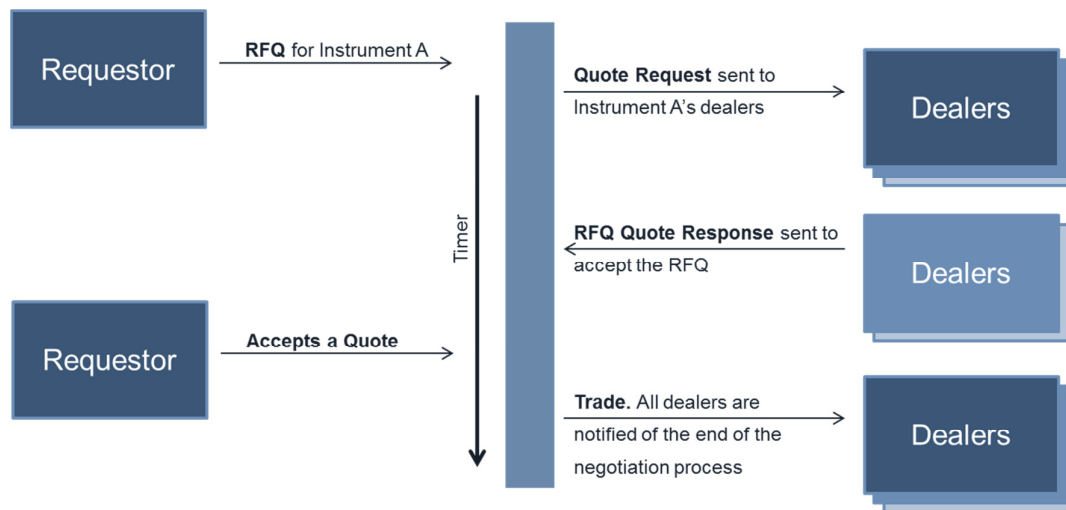
Example highlighting the matching at best quote criteria:
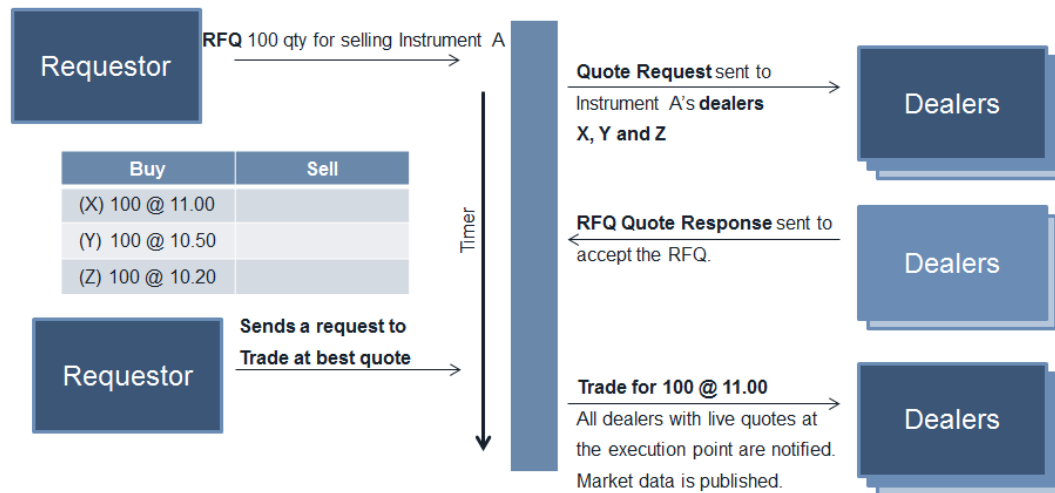
8.2 Types: Anonymous or Named

The RFQ negotiation process can be either anonymous or named (non-anonymous), as per the Requestor's preference.

For anonymous RFQs:

- The RFQ is routed to all authorized Dealers

- The Requestor does not see the identity of each Dealer

- The Dealers do not see the identify of the Requestor

- The Dealers do not see one another

For named RFQs:

- The Requestor must select the Dealers in which the RFQ should be delivered to[4]

- The Requestor has visibility of the identify of the Dealers

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[4] Up to 8 Dealers. Dealer list is available on MIT309 FTP service.

- The Dealers have visibility of the Requestor

- The Dealers do not see one another

8.3 Trading Characteristics

The trading characteristics and operating rules of RFQs are as follows:

- Guaranteed by CC&G (where provided)

- Settlement in T+2 in Monte Titoli

- RFQ trades are considered as "On Exchange" trades

- RFQs trades are made available to the public in real time, and do not contribute towards the formation of any price statistic (dynamic price, reference price or official price)

- Pre-trade transparency handled according to MIFID II rules

- Post trade transparency and transaction reporting are automatically fulfilled

- RFQ trades are accounted for the total volumes of the relevant instrument

- Tick size is 0.001 for all products except those which fall under the MIFID II tick size regime (i.e. linked to tick table TS_06MF)

8.4 Parameters

- Minimum quantity: A member may use the RFQ functionality for sizes above €200,000 for ETFs and ETC/ETNs

- Price validation: RFQ responses are price validated with reference to the order book best bid-offer[5] with the following percentage variation tolerances:

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[5] In cases whereby the best bid-offer cannot be identified, the last trade price is used. Percentage variation tolerances also apply to the last trade price.

- Bond ETFs: 2%

- Equity ETFs and structured non-leveraged ETFs: 2.5%

- Structured leveraged ETFs, Non-leveraged ETFs and double leveraged ETC/ETNs: 5%

- Tripled leveraged ETC/ETNs: 7.5%

- Maximum duration: The negotiation process is subject to a time restriction of 180 seconds. Should the negotiation process not be complete within 180 seconds, all quotes and requests will expire

8.5 Members Set Up

There is a different set up for Requestors and Dealers.

8.5.1 Requestors

All member's CompIDs are eligible to send RFQ requests. The Requestor must register the relevant CompID(s) in the Member Portal for the CompID(s) in which they wish to send RFQs from.

8.5.2 Dealers

Those members who would like to become Dealers and therefore receive RFQs need to follow the below steps:

- Conform their software in order to be enable to answer RFQs

- Set a dedicated CompID up, defined with the letter "R", which allows the CompID to receive and respond to RFQs for the associated instruments. "R" CompIDs are gven 25tps free of charge. If the Dealer supports more than 500 instruments on the ETFplus market, the Dealer will receive 50tps free of charge

- Select the instruments in the Member Portal for which they wish to become an active RFQ Dealer on

Please note that it is not necessary to be a Market Maker (Specialist, Advanced Liquidity Provider or MIFID II Market Maker) in order to become an RFQ Dealer.

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