Borsa Italiana

ETFplus

The ETF and ETC/ETN market: transparency and liquidity

London Stock Exchange Group

"ETFplus is the Borsa Italiana market entirely dedicated to the real-time trading of Exchange Traded Funds (ETF), Exchange Traded Commodities (ETC) and Exchange Traded Notes (ETN). Thanks to its advanced and efficient infrastructure, this electronic market enables investors to access the real-time trading of hundreds of financial instruments easily and transparently."

ETFplus

Transparency and liquidity

Combining risk/ return awareness with regulated trading

Basic elements and characteristics of the market and its instruments
Replicating well known market indices, instruments listed on the ETFplus market enable investors to be fully aware of the risk/return profile of their investment and of the securities portfolio or asset class to which they are exposed. At the same time, the set of rules that defines the fundamental aspects of the organisation and operation of the market, together with the information made available to the public, supports well regulated real-time trading and provides outstanding protection for investors. ETFplus brings all this together in a synthesis characterised above all by transparency.

The operating mechanism of ETFs, ETCs and ETNs and the micro-structure of the ETFplus market make positive contributions to liquidity generation, enabling real-time trading with reduced spreads and sufficient trading book breadth and depth. On the one hand, the ‘creation and redemption’ mechanism makes ETFs, ETCs and ETNs as liquid as the underlying market; on the other, the mandatory presence of a specialist, who places compulsorily bid and ask orders which have a maximum spread and a minimum quantity established by Borsa Italiana, provides liquidity on a continuous basis under the most diverse market conditions.

> “ETFplus is regulated, subject to CONSOB supervision, and governed by a set of clear and non-discretionary rules designed to protect investors.”

ETFplus: a regulated market

800+
instruments listed

Historical evolution and current segmentation

The Italian ETF market was launched in September 2002 when, in a dedicated segment of the Stock Market, trading started on the first indexed funds which replicated the performance of the biggest European blue chip indexes. The ETF tracking FTSE MIB index followed shortly afterwards.

So great was the success of these instruments, year after year, that in April 2007 it led to the creation of a new market: ETFplus, an environment solely dedicated to ETFs, structured ETFs, active ETFs and ETCs/ETNs.

ETF segment

— **Class 1:** ETFs with bond-based reference indices

— **Class 2:** ETFs with equity-based equivalent reference indices.

Structured ETF segment

— **Class 1:** Structured ETFs without leverage effect (short, with protection)

— **Class 2:** Structured ETFs with leverage effect (with long and short leverage).

ETC/ETN segment

— **Class 1:** ETCs/ETNs without leverage effect (classic, forward and short)

— **Class 2:** ETCs/ETNs with maximum leverage effect equal to 2

— **Class 3:** ETCs/ETNs with leverage effect greater than 2.

Active ETFs

— **Class 1:** Bond

— **Class 2:** Equity

— **Class 3:** Structured

2002
First ETFs listed in Borsa Italiana

2003
First ETF on FTSE MIB

2004
First bond ETFs

2005
First emerging market ETF (Hang Seng China)

2006
First commodities index ETFs

2007
Birth of ETFplus market with ETFs, structured ETFs and ETCs/ETNs

2008
First credit index ETFs

2009
First short and leveraged ETCs

2010
First bond short ETFs

2011
500th ETF listed

2012
800th instrument listed

2013
First emerging markets corporate bond ETFs

ETFplus: a regulated, authorized and CONSOB-supervised market

Investor safeguards and guarantees

ETFplus is a regulated, authorised and CONSOB-supervised market. Its organisation and operation are compliant with the MiFID Directive and the related implementing provisions, assuring correct, orderly trading and the efficient execution of orders.

The operating modes are contained in the market Rules (available on **www.borsaitaliana.it**), which establish the laws and transparent, non-discretional procedures applied with regard to:

1 Conditions and procedures for listing financial instruments

2 Conditions and procedures for the participation of intermediaries in the market

3 Trading model and order types

4 Mandatory public disclosure

5 Conditions and procedures for clearing, settling and guaranteeing of concluded trades.

Listing financial instruments

The main requirements

To list financial instruments on ETFplus, the issuer must send the listing application together with the necessary documentation to Borsa Italiana. The examining offices verify compliance with admission requirements and, if these are satisfied, they dispose the admission with a decision. The main requirements for the listing of ETFs and securitised derivative financial instruments (ETCs/ETNs) are indicated in the next paragraphs.

Requirements for ETF listing

ETFs compliant with the UCITS European directive may be listed on the ETFplus market only if:

— they have received CONSOB and Bank of Italy authorisation (or, in the case of foreign CIUs within the European Union, an equivalent authorisation from the home authority) and have completed the procedure for marketing in Italy

— they are freely negotiable and can be settled via Monte Titoli S.p.A.

— the reference index is characterised by transparent calculation methods and is available to the public at least once a day

— the formula linking the performance of the ETF and that of the reference index must be known and transparent

— the ETF's prospectus calls for its listing on one or more regulated markets.

Requirements for ETC/ETN listing

ETC/ETN instruments may be listed on the ETFplus market only if:

— they are issued in accordance with a prospectus prepared according to the requirements of European standards and approved by CONSOB (or, for issues subject to the regulations of other states within the European Union, by an equivalent authority – in which case the passporting procedure must be started)

— they are freely negotiable and can be settled via Monte Titoli S.p.A.

— they are issued by domestic or foreign companies or entities which have published the audited financial statements and of which the sole purpose is to complete one or more issues of financial instruments

— the assets acquired with the proceeds deriving from subscription are separate, for all intents and purposes, from the assets of the issuer, and are intended to fulfil the rights included in the instruments and to cover the costs of the transaction. On these assets, no action is allowed by creditors other than the bearers of the related financial instruments

— the characteristics of the instruments are clear and unambiguous and permit a correlation between the price of the financial instrument and the price or other measure of the underlying

— at least for some categories of qualified persons, continual subscription or redemption is possible, through the delivery of the financial instruments or goods comprising the assets or of an equivalent amount of money.

Access and trade on ETFplus market

ETFplus: a multi-lateral, order driven, fast and efficient electronic market

Operators' access to the market

A broad base of connected intermediaries
All intermediaries who so request may enjoy access to the ETFplus market if the conditions for participation and technological expectations are met, and the processes for settling and paying the contracts closed on the market are safeguarded. Specifically, Borsa Italiana verifies the uninterrupted fulfilment of the following requirements:

1. Sufficient staff with adequate knowledge, experience, training and competence at least in the key role of the business
2. Adequate clearing and settlement arrangements
3. Adequate internal procedures and controls
4. Compliance officers who have a good knowledge and understanding of Borsa Italiana's Rules and the rules governing the functioning of the markets; and who, as part of their role, shall manage the relationship between the firms and Borsa Italiana
5. Adequate technical infrastructures and market connectivity according to the type of activity they want to perform and the number of interconnections they have.

Every day a substantial number of intermediaries, both domestic and international, insert their own and their clients' purchase and sale interests on the ETFplus market, generating high liquidity. The presence of a trading platform shared by all markets of London Stock Exchange Group, of which Borsa Italiana is a part, provides further momentum to ETFplus to expand beyond domestic borders, providing a simple, standardised connection for all intermediaries.

Trading procedures

ETFplus is a multilateral, order-driven, fast and efficient electronic market, able to handle thousands of messages per second, assuring fast order entering and deletion and automatic contract performance execution. Its trading hours are as follows:

— Continuous trading: from 9.00am to 5.25pm
— Closing auction: from 5.25pm to 5.30pm plus a variable interval of up to one minute, determined automatically on a random basis by the trading system.

Contracts are executed through automatic matching of bid and ask orders according to price/time priority criteria.

Characteristics of the market model

Multilateral: All intermediaries who so request, and who meet the regulatory requirements, are allowed access to the market.

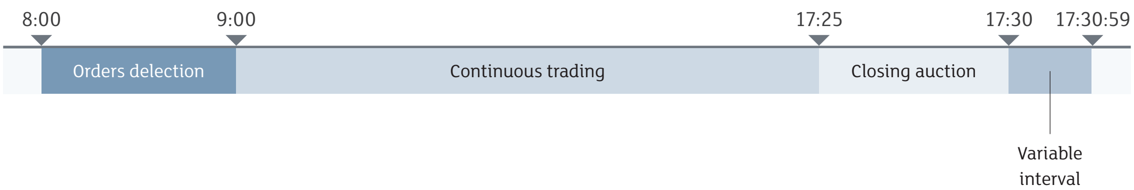
Order-driven: Price formation is driven by all market participants through the automatic matching of orders according to the price-time priority criteria.

Specialist: Liquidity is assured for all listed instruments by the mandatory presence of a specialist operator.

Settlement: Takes place through Monte Titoli on the third trading day following the conclusion of trades. Settlement follows automatic procedures from the matching of orders to final settlement through account crediting.

Central counterparty: Cassa di Compensazione e Garanzia, interposing between buyers and sellers, guarantees the good delivery of the contracts, eliminating counterparty risk.

Trading times



Defining 'price limit' and 'at-best' orders

Order types

An order represents a commitment to trade a financial instrument on the basis of specific price and quantity conditions, according to specific trading procedures set by Borsa Italiana.

The constituent elements of an order

Price: A multiple of the trading tick applicable to the instrument which in some cases may not be indicated (see market orders)

Quantity: Any quantity the investor wishes to purchase/sell

Type of transaction: Purchase or sale

Manner of execution: The validity parameters that characterise the order according to its execution and validity period.

Price of the orders entered (Euro)	Tick
Less than or equal to 0.2500	0.0001
0.2501–1.0000	0.0005
1.0001–2.0000	0.001
2.0001–5.0000	0.0025
5.0001–50.0000	0.005
More than 50.0000	0.01

Borsa Italiana, taking into account the unit value of the financial instruments traded in the ETFplus market, may establish a different tick from that specified in this table. In such an event it will announce the tick in a Notice.

The two main types of orders are 'price limit orders' and 'market orders', also called 'at-best orders'. The former may be executed only at prices equal to or better than the indicated limit. At-best orders, on the other hand, provide no price indication, and determine matching with one or more opposite proposals existing at the time of entering and until available quantities are exhausted. Proposals without price limits can be entered only in the presence of at least one opposite trading proposal with price limit. At-best orders always have higher execution priority than orders entered with price limit, and are not allowed during auction phase.

Orders with partially displayed quantities, called 'iceberg orders', may also be entered. Orders on ETFplus are entered in anonymous form – with the exception of those entered by the specialist operator, who is always identifiable. Specialists support market liquidity using a specific type of order, the executable quote. This allows a purchase and a sale order to be entered simultaneously on the same financial instruments; the orders behave as two independent orders on the book.

"The trading platform shared by all markets of LSEG provides a simple, standardised connection for all intermediaries."

Reference price and trade control parameters

Definition of reference, static and dynamic prices

Segment	Maximum price variation limit of orders vs static price	Maximum price variation limit of contracts vs static price	Maximum price variation limit of contracts vs dynamic price
Indexed ETF – Class 1	10%	3.5%	1.25%
Indexed ETF – Class 2	10%	5%	2.5%
Structured ETF – Class 1	10%	5%	2.5%
Structured ETF – Class 2	20%	10%	5%
ETC/ETN – Class 1	20%	10%	5%
ETC/ETN – Class 2	30%	12.5%	5%
ETC/ETN – Class 3	30%	15%	7.5%

You can verify any subsequent revisions to the table above in the guide to trading parameters on **www.borsaitaliana.it** by following the trail: Borsa Italiana, Rules, Guides and EMS. For each instrument, Borsa Italiana may set different trading parameters from those shown in the table. If so, it will inform the market through a notice.

Reference price
In the ETFplus market the reference price is equal to:

a the closing-auction price

b (where it is not possible to determine the closing-auction price) a significant number of best bids and offers displayed on the order book during the continuous trading phase, giving greater weight to the most recent

c (where it is still not possible to determine the reference price by these means) the reference price of the previous session.

Static price
This is equal to the reference price of the day before; when the first contract of the day is concluded, the price of that contract becomes the new static price for the rest of the day.

Dynamic price
This is equal to the price of the last contract concluded during the start of the session. To ensure proper operation of the market, the following maximum limits are fixed on the movement of prices:

a maximum price variation limit for proposals relative to the static price

b maximum price variation limit for contracts relative to the static price

c maximum price variation limit for contracts relative to the dynamic price.

If, during continuous trading, the price of the contract being closed exceeds the limits relative to the static price or the dynamic price, then continuous trading of the financial instrument is automatically suspended for two minutes and the proposal that caused the suspension is automatically deleted. During the suspension, only order deletion is allowed.

If there is an automatic suspension in the last 2 minutes of continuous trading, this suspension of continuous trading automatically triggers the start of the closing-auction phase. During the auction, only limit orders are allowed. The presence of a specialist, which grants liquidity to the market, is mandatory.

If the difference between the indicative uncrossing price and the static price exceeds the maximum percentage variation, the volatility auction phase will be triggered. It will last for 5 minutes plus a variable interval of up to one minute, determined automatically on a random basis by the trading system. Such an auction phase may be activated only once.

Definition of Cross and BTF

Validity parameters

On the outcome of the order

IOC – immediate or cancel: the order may be executed immediately and only in full. If the requested quantity is not available on the book, the order is deleted.

FOK – fill or kill: in case of partial execution of the order, the unexecuted part is automatically deleted.

On time

Day: an order that, if not executed during the trading day, is automatically deleted at the end of the day.

GTD – good till day: an order that remains on the book until the day specified by the participant (up to 30 days).

GTT – good till time: an order that remains on the book until the day, the minute and the second specified by the participant (up to 30 days).

GFA – good for auction: an order which comes into force when the market enters an auction phase (for ETFplus this applies only to closing auctions).

ATC – at close: an order which is in force only during the closing auction.

Cross and Block Trade Facility

Cross/Block Trade Facility (Cross/BTF) are particular orders which allow intermediaries to enter an already agreed or identified trade.

When the trade is agreed or identified within a single member firm, it is considered an 'Internal Cross/BTF' whereas when it is agreed or identified by two different member firms, it is referred to as a 'Committed Cross/BTF'[1].

For Cross Orders, the price of the order must be within the visible best bid price and the visible best ask price (including those prices).

If the order quantity is equal to or larger than that specified by Borsa Italiana in the Instruction, the price of contracts concluded may fall outside the range established for a normal Cross Order: these orders are called Block Trades. Minimum sizes and the difference between the bid price and the ask prices on the trading book for BTF orders are established in the Instructions, on a general basis and/or for each category of instrument.

BTF orders are permitted when:

a the size of the contract is equal to or larger then 4*EMS[2] and

b the difference between the order price and the best prices on the trading book does not exceed:
- 2% for ETFs, Class 1, and actively managed ETFs, Class 1
- 2.5% for ETFs, Class 2; structured ETFs, Class 1; and actively managed ETFs, Class 2 and Class 3
- 5% for structured ETFs, Class 2, non-leveraged and double leveraged ETCs/ETNs without a leverage effect, Class 1 and Class 3
- 7.5% for triple leveraged ETCs/ETNs with a leverage effect, Class 2.

The execution of Cross Orders counts towards the dynamic price formation, but does not count towards the reference and official price formation. The execution of Block Trades does not count towards any price formation.

"Cross Orders and BTF: an order tailored to every size."

[1] Available only for principal vs Agency and for Agency vs Agency.

[2] For ETFplus market, the EMS (Exchange Market Size) identifies the specialist's minimum quantity obligation for each instrument.

More about the market

From required data to the role of the specialist

Public disclosure

Serving investors through transparency
Maintaining a continuous flow of updated information is a fundamental requirement for guaranteeing the proper operation of the market. Borsa Italiana requires issuers to make available to the public a range of data, such as:

- Net Asset Value (NAV)
- the official value for ETC/ETN
- where provided for by the ETF: the level of protection, the level of guarantee, and the value of the multiple
- the amount of any dividends, the ex-date and the date of payment.

Furthermore, issuers must provide prompt notice of any change to the information contained in the offer documentation about the operating mechanisms of each financial instrument.

Particularly important among the disclosure requirements – for ETFs only – is the publication in Euro of the indicative Net Asset Value (iNAV), the instantaneous value of the ETF which must be published continuously. Borsa Italiana requires issuers to make this value available to the public through traditional information providers or via a website.

Settlement procedures

Post-trading excellence
Contracts concluded on ETFplus are settled through Monte Titoli on the third open market day after the closing day of the contracts. Transactions closed on the ETFplus market are covered by the guarantee provided by the central counterparty, Cassa di Compensazione e Garanzia, which eliminates counterparty risk as the sole guarantor of proper completion, acting as purchaser with respect to the seller and vice versa. Cassa di Compensazione e Garanzia and Monte Titoli are companies of London Stock Exchange Group; together with Borsa Italiana, they provide an efficient, integrated service from trading to post-trading.

The specialist

Market liquidity and the specialist's role
The liquidity of any listed financial instrument depends on the continuous presence, on the trading book, of both purchase and sale proposals with competitive spreads and high quality. In other words, it relies on the trading book being broad and deep enough. In the light of this, and with the aim of assuring maximum liquidity for each instrument listed on the ETFplus market, it is mandatory to have a specialist operator who assures that liquidity and is committed to complying with quoting obligations.

Quoting obligations consist of:

1. **Obligation to display bid and ask prices continuously:** the specialist is always exposed on the book both with a purchase price and with a sale price. This assures investors that they will always find an up-to-date valuation of the instrument of interest, and can at any time dispose of an investment or, conversely, make it and increase it. When the specialist is hit on the book, he has five minutes to restore the quotes.
2. **Obligation to display a minimum quantity:** the obligation to be present on the book must satisfy a minimum quantity in terms of the number of instruments (EMS – exchange market size). Minimum quantities are recalculated twice a year on the basis of the updated prices of the instruments.
3. **Maximum spread obligation:** the purchase and sale presence obligation must comply with a maximum differential between bid and ask price.

These obligations are defined by Borsa Italiana according to the specific characteristics of each instrument as well as the exchange volumes and associated volatility of its underlying market. They take into consideration every aspect that could affect the activity of the specialist (such as variation in trading times between the underlying asset and the instrument, exchange rate risk, etc.). The obligations are available for consultation on the Borsa Italiana website.

“The mandatory presence of the specialist assures liquidity to the market.”

Market supervision
Obligation compliance is carefully monitored by Borsa Italiana, which in cases of non-compliance may intervene and apply sanctions against the specialists in question.
In verifying compliance, among other elements a synthetic indicator is taken into account: epsilon, which is calculated on a monthly basis and measures compliance with the three obligations described above.

Epsilon (%) = 0.4 * P_ratio + 0.4 * S_ratio + 0.2 * Q_ratio

where:

- **P_ratio** is calculated on the basis of the number of minutes of compliance with the continuous quotation obligations
- **S_ratio** is calculated on the basis of the number of minutes of compliance with the spread obligations
- **Q_ratio** is calculated on the basis of the number of minutes of compliance with the minimum quantity obligations.

At the written request of specialists, Borsa Italiana may suspend or temporarily reduce the obligations in the light of documented causes that affect the fulfilment of the obligation itself.

Liquidity providers
In addition to the specialists, the ETFplus market also provides for the optional presence of one or more liquidity providers. These intermediaries, without any obligation, support the liquidity of ETFs and ETCs/ETNs by giving exposure to purchase and/or sale trading proposals, thereby contributing to the broadening and deepening of the trading book.

Borsa Italiana

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