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Frequently Asked Questions on the Temporary Ban on Net Short Positions of 17 March 2020

Commissione Nazionale Per Le Societa E La Borsa (CONSOB)

CONSOB

FREQUENTLY ASKED QUESTIONS ON THE TEMPORARY BAN ON NET SHORT POSITIONS OF 17 MARCH 2020

This is a series of responses to questions on the interpretation of the ban adopted by CONSOB on 17 March 2020. The FAQs may be updated and extended at any time. Please consult the latest version available on the CONSOB´s website at the following webpage:

http://www.consob.it/web/consob-and-its-activities/short-selling

Version of 18 May 2020

1. Who is subject to the prohibition?

The prohibition applies to any natural or legal person (hereinafter "investor"), irrespective of their country of residence, regardless of whether trading takes place in Italy or in another EU or non-EU country, on a trading venue or over-the-counter ("OTC").

This means that the prohibition applies to the own accounts of intermediaries as well as to the accounts of the final investors.

The ban does not affect market making activities, provided that these activities have been exempted following the procedure under Article 17 of Regulation (EU) 236/2012 (see point no. 11 below).

The scope of application of the ban depends also on the competent authority of the most relevant market in terms of liquidity for a given financial instrument, as more precisely indicated in point 7 below.

1-*bis*. Does the prohibition also apply to retail investors?

Yes. Resolution no. 21303 of 17 March 2020 has the objective of preventing any bearish transaction, by anyone, which creates or increases a net short position on one or more of the restricted shares, i.e. a position which confers a financial advantage in the event of a fall in the price of such shares.

Therefore, short selling or other types of bearish transactions on the restricted shares are prohibited (e.g. purchase of a put option).

An investor who has purchased restricted shares, and does not hold any other short position, can sell the shares, as this activity would not create a net short positions.

Bearish transactions on index-related instruments that include such shares are prohibited if the weight of the restricted shares exceeds 20% of the index. As the FTSEMIB index is entirely composed, as it is the case with other indexes, of restricted shares, bearish transactions on FTSEMIB-related instruments (e.g. sale of a miniFIB, purchase of a "bearish" ETF) is prohibited, unless the investor has a long position on all the shares making up the FTSEMIB index in the correct proportions.

The prohibitions above also apply to intraday transactions, regardless of their value.

The prohibitions, however, do not apply if the bearish transactions on the restricted shares are carried out to hedge a long position.

In such cases, however, it is necessary to pay special attention to the fact that the short position taken with the bearish hedging transactions is not greater than the long position that is intended to hedge, as it would create a net short position and constitute a breach of the Resolution.

In this regard, we inform you that Consob will not provide answers to questions relating to investor-specific situations, but will update these FAQs if the question submitted is of general interest.

2. When will the prohibition come into force and how long will it be in force?

The restrictions will apply from the start of the trading day of 18 March 2020 for a period of three months.

Pursuant to resolution no. 21367 of 15 May 2020, restrictions have been revoked starting from 19 May 2020. Consequently, the ban applied until the end of the trading day of 18 May 2020.

3. To which financial instruments does the prohibition apply?

The prohibition applies to shares included in the list attached to the resolution (hereinafter “restricted shares”), as well as to related instruments included in the calculation of net short position, like saving/preferred shares, derivatives, depositary receipts, index-related instruments (see point no. 9 below).

The relevant provisions of Regulation (EU) no. 236/2012 on the calculation of net short position apply (i.e. Article 3 of Regulation no. 236/2012 and Articles 5, 6, 7 and 10 and Annex I and II of Commission Delegated Regulation no. 918/2012 and the relevant ESMA FAQs).

In short, the net short position is the sum of all short positions minus all long positions held by that investor in relation to restricted shares and related instruments.

Long and short positions are to be included in the calculation of net short positions at the time of entering into the agreement to buy or sell the financial instruments which creates the position. Actual delivery date of the financial instruments (e.g. T+2) is not relevant in this regard. For instance, trades executed on a trading venue are to be included in the calculation on trading date. Subscription of financial instruments yet to be issued is to be included in the calculation at the time the investor has committed to underwrite irrevocably the financial instruments and has received confirmation from the issuer about the number of new financial instruments to be delivered.

The net short position has to be calculated in terms of number of shares, not considering their values.

By means of illustration, positions stemming from the following transactions, among others, shall be considered in the calculations:

- purchases or sales of shares;
- transactions in options, swaps, futures, contracts for difference, covered warrants, certificates.

Financial instruments which entail a bearish position, such as the purchase of put options, shall be considered as short positions.

Positions in derivatives have to be delta adjusted, according to Annex II, Part 1, of Commission Delegated Regulation no. 918/2012.

In detail, according to Delegated Regulation no. 918/2012, the delta of a derivative is to be calculated daily by the investor who holds the instrument, taking into account the closing price of the underlying shares.

For instance, a put option on a notional value of 1,000 shares X with delta of 0.3 is equivalent to a short position on 300 shares X (1,000 * 0.3). In order to purchase the put option, the investor must have previously purchased at least 300 shares X, so that its net position is balanced and a short net position is neither created nor increased.

If the delta of the put option increases to 0.4 on the following day (for example, due to a drop in the share X price), the short position will be equivalent to 400 shares X (1.000 * 0.4). In this respect, please note that short net positions due to a variation of the relevant delta are allowed (see point no. 8).

As for *future* contracts on index, the number of shares of each issuer making up the index depends on the index construction methodology as defined by the administrator and may vary following any periodic review.

As highlighted in ESMA Q&A (No. 6.6), all classes of shares (e.g. common, preferred, savings shares) issued by the same issuer are to be taken into account for the calculation of net short positions, irrespective of the shares' voting rights ("*All classes of issued shares should be considered in the calculation of the net short position (both numerator and denominator) irrespective of their characteristics (common stock, preferred, saving, etc.) as the regulation refers to the issued share capital of an issuer, in particular irrespective if voting rights are included or not*").

Thus, buying common shares and selling an equal quantity of saving shares of the same issuer is allowed. In such situations, the net short position in the issuer shares has to be calculated by adding up all short positions in all classes of shares of the same issuer minus all long positions in all classes of shares of that issuer. For instance, an investor who sold short 800 saving shares of issuer X and bought 500 common shares of the same issuer has a net short position equal to 800 – 500 = 300 shares. Please note, as previously highlighted, that the net short position has to be calculated in terms of number of shares, not considering their values.

Fixed income instruments or instruments that transfer an exposure to the creditworthiness of any share issuers (such as credit default swap) shall not to be taken into account.

Sovereign bonds and related instruments (e.g. future on sovereign bond) are not affected by the restrictions.

Similarly, the prohibition does not apply to commodity-related financial instruments (e.g. ETC on gold or oil) nor to financial instruments linked to index dividend (e.g. FTSEMIB Dividend).

Borrowed or lent securities are not included in the calculation of the position. In particular, securities lending transactions whereby shares are lent shall not be considered as creating a short position for the lender. On the other hand, securities lending transactions whereby shares are borrowed shall not be considered as a long position for the borrower. The same applies to repo.

However, short sales backed by securities lending or repos are not allowed, unless the investor holds an equivalent long position in the same share. Special provisions apply to short positions backed by long positions in subscription rights and convertible bonds (see also point no. 12 below).

4. What does the investor need to check before entering into a transaction in relation to the restricted shares or related instruments?

The investor must ascertain that the intended transaction in the financial instrument does not create or increase a net short position in a restricted share. Special care must be taken when dealing in derivatives since positions shall be accounted on a delta-adjusted basis.

5. Are intraday net short positions allowed?

No, creating or increasing a net short position (whatever the type of transactions used) during the trading day is prohibited, even if the investor intends to close the position before close of business on that day.

6. What should be done by an investor who opened a net short position before the entry into force of the prohibition?

The prohibition only refers to creating or increasing a net short position. Therefore, the investor who opened a net short position before the entry into force of the prohibition can reduce it or keep it. Keeping a previous net short position unaltered does not infringe the prohibition. On the other hand, increasing a position after having reduced it is not allowed.

In case an investor had placed an order that is not executed by the time the prohibition has entered into force and, if executed, would create or increase a net short position, the investor must cancel that order.

See also point no. 8 regarding derivative instruments.

7. Does the prohibition apply to transactions in the concerned financial instruments executed outside an Italian market?

Yes, the prohibition applies regardless of the trading venue where the transaction is executed if it results in creating or increasing a net short position in a restricted share. Therefore, it applies to transactions carried out on a regulated market or an MTF within and outside Italy. Similarly, the prohibition applies to OTC transactions.

All this applies in relation to financial instruments for which Consob is the "relevant competent authority" in the meaning of Regulation No 236/2012, which corresponds, by and large, to the competent authority of the "most relevant market in terms of liquidity", as determined in accordance with Commission Delegated Regulation (EU) No 590/2017, supplementing Regulation (EU) No 600/2014.

In order to verify the competent authority of the most relevant market in terms of liquidity for a given financial instrument, one may refer to ESMA website, in the FIRDS ("Financial Instrument Reference Data") section.[1]

The ban also applies to trading of "*global depositary receipts*" and OTC derivative contracts linked to the restricted shares, exception made for OTC derivative contracts where the underlying is in its turn a derivative contract (linked to the same shares) for which Consob is not the relevant competent authority in the meaning of Regulation No 236/2012.

8. Is an investor allowed to create a net short position in a restricted share by using derivatives?

No, investors are not allowed to use derivatives to create or increase a net short position; they may only use derivatives to hedge, create or increase a net long position.

However, in case a net short position is increased passively due to a variation of the relevant delta, this is not considered an infringement to the prohibition.

Similarly, the increase in a short net position due to a change in the composition of an index on which an investor has taken a short position (for instance through a future or another derivative linked to the index/basket) is not considered an infringement of the ban.

Regarding the creation or increase of a short net position due to the expiry of a long position, this is considered to be a passive variation, and thus allowed, only when the long position has been taken before the application of the restrictive measures (i.e. before the start of trading of 18 March 2020). This is in line with the general prescription (see point 6 above), according to which it is not allowed to increase a net short position after having reduced it.

For instance, if an investor holding a net short position at the moment of entering into force of Consob Resolution (18 March 2020) subsequently takes a long position (e.g. by buying a future on FTSEMIB index), in order not to increase her net short position, after having reduced it, she is under the obligation to keep the long position (e.g. by rolling forward the future); alternatively, the investor shall first close the short position (or reduce it as necessary) and then let the long position expiry (or close it).

In the above-mentioned cases, investors are required to notify their net short positions if they reach a relevant threshold (i.e. 0.1%, 0.2%, 0.3%, 0.4% of the issued share capital and so on) entering, in the field "comments" of the notification, that the variation in the position has been caused by a variation of the relevant delta o by index rebalancing.

[1] <https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_firds>.

It should be highlighted that it is not considered to be a passive behaviour, and thus it is forbidden, to create or increase net short positions in restricted shares following transactions executed intentionally by an investor from 18 March 2020 onwards (with the exceptions allowed, see points 9, 11 and 12). For instance, an investor holding, before 18 March 2020, a "neutral" position in restricted shares, composed of shares and corresponding short positions, shall not, from 18 March 2020 onwards, sell shares because such transactions would create net short positions in such shares.

Furthermore, following a change in the composition of an index, the weight of the restricted shares on the index may exceed the 20% threshold. In such situation, the index-related financial instruments will be affected by the ban as from the date on which the change in the composition of the index became effective.

8-*bis*. Is it allowed to roll-over positions on derivative financial instruments?

Investors holding a net short position in a restricted share through expiring derivatives are allowed to roll it forward, on condition that by doing so their position is not increased.

9. Are trades in index-related instrument that contain one or more restricted shares allowed?

Trading in index-related instruments (like futures and other derivatives, ETFs, certificates) is not affected by the restriction if the overall weight of the restricted shares in the index is equal to or lesser than 20%.

At the opposite, trading in index-related instruments is affected by the restriction when the overall weight of the restricted shares in the index is greater than 20%, on condition that Consob is the relevant competent authority in the meaning of Regulation N. 236/2012.

The ban also applies to trading of OTC derivative contracts linked to indexes for which the overall weight of the restricted shares is greater than 20%, except for OTC derivative contracts whose underlying is in its turn a derivative contract (linked to an index for which the overall weight of the restricted shares is greater than 20%) for which Consob is not the relevant competent authority in the meaning of Regulation No 236/2012.

In this last respect, reference is made to point 7 above, with no need for the above condition to be repeated in each and every of the examples reported below.

For example, selling a future on the FTSEMIB index or buying an ETF which entails a bearish position on the same index is impacted by the ban, as the FTSEMIB index is composed entirely of restricted shares.

With respect to portfolios of Italian securities hedged through short positions on the FTSEMIB index, it is noted that possible net short positions on single constituents of the same index are subject to the same conditions indicated in Consob Resolution for net short positions in general: it is forbidden to enter into <u>new</u> net short positions on single constituents of the FTSEMIB index and holders of net short positions on single constituents of the FTSEMIB index are allowed to <u>maintain them</u>, but are not allowed to increase them.

Nevertheless, the above prescriptions do not apply to net short positions on single constituents of the FTSEMIB index stemming from short positions on the FTSEMIB index future if each and every of the following conditions hold true at any time:

1. The portfolio, or part of it, is diversified and consists of Italian shares;
2. The value of the portfolio, or part of it, is correlated to the price of the FTSEMIB index future; the holder of the portfolio, or part of it, shall be able to prove the existence of correlation in case of request by Consob;
3. Short positions on single constituents of the FTSEMIB index are proportionate to the long positions that satisfy conditions 1) and 2) above; and
4. Net short positions on single constituents of the FTSEMIB index are not entered into with the aim of circumventing the ban established by Consob Resolution, which, on the contrary, would be the case, for instance, for a strategy consisting in entering into a net short position on one or more of the single constituents of the FTSEMIB index only.

Moreover, the following trading strategy is forbidden:

1) buying one of the FTSEMIB constituents; and
2) selling the index for the same turnover;

as this strategy would create net short positions in all FTSEMIB constituents but one.

Among the indexes for which the total weight of restricted shares is above 20% is the EURO STOXX® BANKS INDEX. Trading in the financial instruments (linked to the latter index) indicated in the embedded excel file is impacted by the ban.

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Generally speaking, it is forbidden to enter into net short positions through:

- financial instruments – for which Consob is the relevant competent authority in the meaning of Regulation N. 236/2012 (see point 7 above) – linked to any other index for which the total weight of restricted shares is above 20%; and
- OTC derivative contracts linked to indexes for which the overall weight of the restricted shares is greater than 20%, as detailed above.

At the opposite, trading in financial instruments linked to, for instance, the EuroStoxx 50, STOXX® Europe 600, MSCI Europe and MSCI EMU indices is not affected by the ban, as the weight of restricted share in these indices is below the 20% threshold.

Regarding trading in other indices, investor should carry out all reasonable efforts to be sure that the Italian restricted shares do not represent more than 20% of the index weight, including acquiring the index composition. In case of doubt, Consob recommends to abstain from assuming short positions in such index.

However, creating or increasing a net short position in a restricted share by combining transactions in index-related instruments and other transactions is prohibited. For instance, it is prohibited to implement a strategy consisting in:

- selling futures contracts on an index whose underlying basket includes restricted shares, and
- buying futures contracts on all/most of the securities included in the underlying basket of the index except for restricted shares.

It is up to each investor to be able to prove that the transactions on index -related instruments are not carried out to enter into short strategies over restricted shares and circumvent the restrictions.

Please note that if, due to index trading, a net short position in a restricted share reaches a relevant threshold (i.e. 0.1%, 0.2%, 0.3%, 0.4% of the issued share capital and so on), the position holder has the obligation to notify to Consob the change in the net short position. In this case, it is recommended that the position holder clarifies, in the field "comments" of the notification, that the variation in the position has been caused by index trading.

Please note that, following ESMA Decision of 16 March 2020, the minimum threshold for net short positions reporting of shares admitted to trading on a regulated market has been lowered to 0.1% of the share capital.

Finally, it should be noted that, for the purpose of applying the restrictive measures, baskets of shares are assimilated to indices. An investor can therefore take a short net position through financial instruments linked to a basket of shares, provided that the weight of the restricted shares in the basket does not exceed 20%.

10. If a fund manager acts on behalf of multiple funds, should the calculation of the net short position be made at the fund-specific or manager level or both? What about groups?

The rules provided for in Regulation no. 236/2012 apply. Thus, the calculation has to be performed at the level of the managing company. In case of groups, the calculation has to be done both at the individual entity level and at the group level.

11. Are market makers exempted?

Yes, market making activities as defined by Article 2(1)(k) of Regulation No. 236/2012, are exempted from the ban, provided that the entity performing the market making activity is included in the list published by ESMA and that the market making activity has been exempted following the procedure under Article 17 of Regulation (EU) 236/2012.

12. Can you clarify the treatment of subscription rights and convertible bonds?

As provided for in Consob Resolution, the restrictions do not apply to the creation of, or increase in, net short positions in a restricted share when the short position is aimed exclusively at covering the risk stemming from the equity component of convertible bond previously purchased which convert in that restricted share.

The same exemption applies to short positions in a restricted share aimed at covering the risk stemming from subscription rights previously purchased which give the right to subscribe restricted share yet to be issued.

This means that, for instance, an investor can buy subscription rights or convertible bonds and sell a corresponding number of underlying shares.

In determining the corresponding number of shares, the investor must calculate and apply the relevant delta (see point no. 3 above). Subscription rights and convertible bonds which have been exercised by the investor have a delta equal to 1.

In both cases, the investor shall report to Consob the net short position stemming from such risk hedging activity. In this case, it is recommended that the investor clarifies, in the field “comments” of the notification, that the short position is backed by long positions in subscription rights or convertible bonds.

Please note that, following ESMA Decision of 16 March 2020, the minimum threshold for net short positions reporting of shares admitted to trading on a regulated market has been lowered to 0.1% of the share capital.

13. Enforcement – What would be the consequences of non-compliance with the prohibition?

According to Article 193-*ter* of the Italian Consolidated Law on Finance, anyone who breaches the measures adopted by competent authorities pursuant to Articles 20 of the Regulation no. 236/2012 can be fined from 25,000 euro to 2,500,000 euro. The fines can be increased depending on the personal qualities of the guilty subject, the entity of the product or profit gained by the illicit fact or by the effects produced on the market. The application of the fines entails the confiscation of the product or profit gained by the illicit fact.

14. Is there any obligation for an intermediary to monitor compliance with the ban by its clients?

The intermediary shall inform its clients about the ban. The intermediary can rely on information provided by its clients on their net positions, for instance information on long positions held at other intermediaries or stemming from trading activity carried out with other intermediaries.

15. Can an investor short sell non-Italian shares?

Restrictive measures to net short positions in Spanish, French, Belgian, Austrian and Greek shares have been adopted by the national competent authorities of these countries (CNMV, AMF, FSMA, FMA, HCMC).

Please check their websites (https://www.cnmv.es/portal/home.aspx; https://www.amf-france.org; https://www.fsma.be/en; https://www.fma.gv.at/en/; http://www.hcmc.gr/en_US/web/portal/home) for additional information.

Currently, no other bans on short selling have been adopted by other European authorities or by US authorities on their securities. It is nevertheless recommended that, before entering into short selling in these securities, investors check the website of the respective authority.

Any additional question can be sent to: shortselling-service@consob.it**.**