

**The assessment report  
on the kdpw\_stream's compliance with the ESCB-CESR  
recommendations for securities settlement systems**

## **I. Introduction**

### **General**

Presented assessment of securities settlement system kdpw\_stream has been carried out jointly by the National Bank of Poland (NBP) and by the Polish Financial Supervision Authority (Polish FSA). The above mentioned authorities have closely cooperated in identifying the scope of the assessment as well as in collecting and revising the information provided by the National Depository of Securities (KDPW S.A.) – Polish central securities depository (CSD), which is the operator of the kdpw\_stream system. The conclusions of the assessment reflect common opinion of both institutions, i.e. the National Bank of Poland and Polish Financial Supervision Authority. The assessment complies with Recommendations and methodology drawn by the European System of Central Banks (ESCB) and the Committee of European Securities Regulators (CESR).

### **Scope of the assessment**

The assessment covers the securities settlement kdpw\_stream system provided and operated by KDPW S.A. KDPW S.A. is Poland's CSD and is one of two operators of domestic systems for securities settlement (Register of Securities - Rejestr Papierów Wartościowych, where Treasury bills and NBP bills are registered, deposited and settled is operated by NBP). KDPW's securities settlement system was established in 1991 as an integral part of the Warsaw Stock Exchange. Since 1994 onwards, KDPW S.A. is an independent joint-stock company. The company's shareholders are the State Treasury, the Warsaw Stock Exchange, and the National Bank of Poland, each of them with an equal holding of 33.33%. The main statutory responsibilities of KDPW S.A. consist of the following: central securities depository, registration of financial instruments other than securities which have been admitted to regulated stock exchange or over-the-counter trading, or introduced in an alternative trading system, clearing and settlement of transactions in dematerialized securities or other financial instruments, operating of a system for ensuring transaction clearing and settlement liquidity. On 1<sup>st</sup> of July 2011 KDPW S.A. has outsourced clearing functions, including its responsibilities related to the Transaction Settlement Liquidity Guarantee System (i.e. Clearing Guarantee Fund), to KDPW\_CCP S.A. – the company entirely owned by KDPW S.A. Since 1<sup>st</sup> of July 2011, clearing of transactions in securities and other financial instruments which are registered in kdpw\_stream, is carried out by KDPW\_CCP S.A., while the settlement of the transactions (transfers between depository accounts) is performed by KDPW S.A. KDPW\_CCP S.A. takes over clearing of the transactions concluded on the regulated cash and derivatives markets as well as in an alternative trading system. KDPW\_CCP S.A. holds funds in amount of PLN 100 million. If assets available in the entire guarantee system for the settlement of transactions concluded on the regulated market are insufficient to clear transaction, ultimately the capital of KDPW\_CCP S.A. can be used to clear the transaction.

Kdpw\_stream system was launched on August 3, 2009. This platform integrates the depository and settlement activity of the Polish CSD. Kdpw\_stream is a system which settles transactions executed on the Warsaw Stock Exchange, BondSpot, NewConnect (MTF), BondSpot ATS, Treasury BondSpot Poland and non-regulated OTC market transactions.

The following securities are registered in the kdpw\_stream system: shares (foreign and domestic), bonds (treasury, central bank, corporate, municipal, convertible, EIB, with priorities rights, non-public bonds, mortgage bonds), exchange traded funds (ETFs), investment fund certificates and derivatives (futures contracts, index participation units, options).

### **Institutional and market structure**

According to the Act of 29 July 2005 on Trading in Financial Instruments (Journal of Laws of 2010 No. 211, item 1384), only joint-stock companies and investment firms can act as trading platform operators. Platform operators manage stock exchange markets, multilateral trading facilities (MTFs) and OTC markets. Currently the main trading platforms in the Polish capital market are:

- The Warsaw Stock Exchange (WSE) – the regulated stock exchange market,
- BondSpot – the off-exchange regulated market,
- NewConnect – the MTF operated by the WSE,
- Alternative Trading System organized by BondSpot – the MTF,
- Treasury BondSpot Poland – non regulated market organized by BondSpot.

The principles of operating trading platforms are regulated by the Act on Trading in Financial Instruments.

All securities admitted to trading in the regulated market must be registered in kdpw\_stream. The securities are registered at the request of the issuer. All securities transfers are made by book-entry form. Securities issued and registered to the securities account of the first owner enter trading in the secondary market. Trading in the secondary market results with the execution of transactions in securities (matching buy and sell orders) between investors. In order to execute a transaction in the regulated or MTF market, a customer submits a sell or buy order for financial instruments to the investment firm. The order is verified by the investment firm (checked whether the investor holds securities intended for sale on its account, or whether the investor has sufficient amount of cash necessary to purchase securities) and then it is passed on for execution. The matched orders form a transaction. Upon its conclusion, a market operator sends a confirmation of the execution of the trade to the investment firms. The investment firm informs the investor that the transaction has been executed. Upon approval by the investment firm the confirmation of the trade is sent to the clearing house KDPW\_CCP S.A. for clearing.

According to the Article 45b of the Act on Trading in Financial Instruments, clearing of transactions in financial instruments shall indicate the amount of monetary and non-monetary obligations under the executed transactions which shall be discharged by participants being parties to the transactions or other participants which have undertaken to perform the obligations

related to such clearings. On the basis of the transaction confirmation received from the regulated market and MTFs, KDPW\_CCP S.A. calculates the debits and credits in respect of the financial instruments involved in the transaction and the funds, taking into account the planned date of execution of the obligations. Obligations which arise under individual transactions may be calculated separately on a gross basis, or netted. The last element of clearing is the verification of the availability of securities and funds necessary to execute the obligations. If they are available, the transaction is passed on for further processing – settlement.

Settlement of transactions in financial instruments is debiting or crediting a deposit account or the securities account kept within kdpw\_stream, in relation to, as the case may be, the transaction to dispose of or to acquire financial instruments, and, accordingly to the amounts determined during the clearing of obligations, debiting or crediting a bank account or a cash account indicated by a participant being party to the clearing. In Poland, under the Act on Trading in Financial Instruments, the settlement of transactions executed in the regulated market and in the MTF can be carried out by KDPW S.A., the company to which the KDPW S.A. has delegated the performance of the activities related to the tasks concerning the operation of the depository for securities or a settlement house. Obligations resulting from transactions may be effected on the trade day or on any other day indicated in the transaction as the settlement day.

In the Polish capital market, trade can be made in: shares, transferable rights to shares, investment certificates and ownership rights in exchange traded funds (ETFs), all of which are concluded on a session on regulated markets, and settled on a T+3 basis. Trades in bonds concluded on a session on the stock exchange are settled on a basis of T+2. Off-session stock exchange block transactions and block transactions concluded in the alternative trading system organised by the Warsaw Stock Exchange are settled on the date specified by the parties to those transactions. Settlement may take place on a delivery versus payment (DvP) basis or a free of payment (FoP) basis, depending on whether the payment is made upon the delivery of securities or not.

KDPW S.A. accepts Polish and foreign companies as participants. Participation requirements are stipulated in the Act on Trading in Financial Instruments and in the KDPW Rules. In 2010, 72 entities were participating in the kdpw\_stream, also 780 share issues and 320 bond issues were deposited in 2010. Capitalization of shares deposited with KDPW S.A. was EUR 132 billion and capitalization of bonds was EUR 125 billion in 2010. The value of secondary market trading cleared in 2010 was EUR 2 billion.

### **Description of regulatory structure and practices**

KDPW S.A. was established pursuant to the Act of 22 March 1991 on Public Trading in Securities and Trust Funds (Journal of Laws of 1991 No. 35, item 155). The activities of KDPW S.A. are regulated by the Act on Trading in Financial Instruments and Government Regulations to this Act. Another regulation within the regulatory framework relating to SSS is the Act of 24 August 2001 on Settlement Finality in Payment and Securities Settlement Systems and the Rules

of Oversight of these Systems (Journal of Laws of 2001 No. 123, item 1351), which implements the Settlement Finality Directive in Poland.

KDPW S.A. is subject to regulation, supervision and oversight of the Polish Financial Supervision Authority. The National Bank of Poland supports Polish FSA in conducting oversight.

The Polish Financial Supervision Authority is the central authority of state administration which supervises the KDPW S.A. The scope of the Polish FSA's supervision is defined in the Act of 29 July 2005 on Capital Market Supervision (Journal of Laws of 2005 No. 183, item 1537) and the Act on Trading in Financial Instruments. Pursuant to the Act on Trading in Financial Instruments, Polish FSA shall have the right to: enter the registered office of the KDPW S.A. in order to inspect the books, documents and information stored in other forms, participate in meetings of the supervisory board of the KDPW S.A. and in general shareholders meetings, raise objections to any intended direct or indirect acquisition of or subscription for a specified number of shares in the KDPW S.A.

KDPW Rules and its amendments, which regulate clearing and settlement functions of KDPW S.A. are subject to the Polish FSA approval, issued after obligatory consultation with the President of the NBP.

The NBP has also important tasks related to the oversight of Polish SSSs. First of all, under the Act on Trading in Financial Instruments, the President of the NBP notifies Polish FSA about any events in which KDPW S.A. activities in carrying out the settlement of the securities do not provide security and efficient operation of the SSS. Moreover, the establishment of a new SSS or the change of its functioning principles, in accordance with the Act on Settlement Finality in Payment and Securities Settlement Systems and the Rules of Oversight of these Systems, that requires the consent of the Polish FSA, is issued after consultation with the President of the NBP.

### **Information and methodology used for assessment**

This assessment has been performed according to the assessment methodology provided by ESCB-CESR for Securities Settlement Systems. The assessment was prepared on the basis of available information as of August 2011. The following sources of information were used for the purpose of this assessment:

- the recommendations of ESCB-CESR;
- the responses provided by KDPW S.A. to the key questions of these recommendations;
- legal acts regulating KDPW S.A. activities;
- legislation governing the supervision of the Polish FSA and NBP;
- the KDPW Rules and the Detailed Rules of Operation of KDPW;
- publicly available documents issued by KDPW S.A., the Polish FSA and the NBP on their official websites.

The assessment is based on 19 recommendations. Each recommendation had received one of the following statuses: observed, broadly observed, partly observed or not observed.

Eighteen of nineteen Recommendations are observed by the Polish FSA/NBP whereas one Recommendation is partly observed.

Above is illustrated in the table below:

<b>Recommendation</b>	<b>Observance</b>
1. Legal framework	Observed
2. Trade confirmation	Observed
3. Settlement cycles	Observed
4. Central Counterparties	Partly observed
5. Securities Lending	Observed
6. Central Securities Depositories	Observed
7. Delivery Versus Payment	Observed
8. Timing of settlement finality	Observed
9. CSD risk controls to address participants' failure to settle	Observed
10. Cash settlement assets	Observed
11. Operational reliability	Observed
12. Protection of customers' securities	Observed
13. Governance	Observed
14. Access	Observed
15. Efficiency	Observed
16. Communication procedures and standards	Observed
17. Transparency	Observed
18. Regulation and oversight	Observed
19. Risks in cross-border links	Observed

## **Summary**

Polish FSA and NBP share one single view that kdpw\_stream has been positively assessed against ESCB-CESR recommendations, and that the identified shortcomings are minor. In the opinion of two assessors, the risk posed by kdpw\_stream cannot be considered as unacceptable from the financial market stability perspective.

## **RECOMMENDATION 1: LEGAL FRAMEWORK**

*Securities settlement systems, links between them or interoperable systems should have a well-founded, clear and transparent legal basis for their operations in the relevant jurisdictions.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 1 is observed.

### **Laws and regulations**

KDPW S.A. as a joint-stock company, established in Poland is subject to Polish company law. The legal foundation of KDPW S.A. is defined by the Company Code and by the Act on Trading in Financial Instruments. The functioning of securities settlement system (kdpw\_stream) operated by KDPW S.A. is regulated by the Act on Trading in Financial Instruments and by the Act on Settlement Finality in Payment and Securities Settlement Systems and the Rules of Oversight of these Systems. These acts provide applicable, non-negotiable contractual provisions governing the operation of the SSS. Internal consistence of the applicable legislation, regulations and rules has never been successfully challenged. The Parliament Acts governing the capital market in Poland are published on the website of the Polish Financial Supervision Authority.

The principles of the securities settlement system operation are defined by the internal company regulations, i.e. the KDPW Rules, which define the operating principles of the system, and the Detailed Rules of the National Depository for Securities. Both of these regulations, along with acts defining the legal foundation of the company are published on company's website in Polish and English and are readily accessible to the participants and to the public.

### **Enforceability of rules, procedures and contracts**

The legal basis for dematerialization of securities, transfer of securities by book entry, the validity and enforceability of all the aspects of the settlement process, as well as netting and collateral arrangements is provided by the Act on Trading in Financial Instruments, Government Regulations to this Act, Act on Settlement Finality in Payment and Securities Settlement Systems and the Rules of Oversight of these Systems, Act on certain Forms of financial Collateral, Bankruptcy and Reconstruction Law and by the KDPW Rules. These provisions form sound and clear legal basis for kdpw\_stream operation.

KDPW S.A. in its capacity as system's operator, provides market participants with information on several specific issues regarding the legal framework of the operator of the SSS. These issues include the information on:



- (1) the legal status of the securities settlement system operator;
- (2) the legal regime governing the system;
- (3) the rules governing access to the system;
- (4) the legal nature of the securities held through the system, e.g. bearer, dematerialized, etc.;
- (5) the applicable law governing the contractual relationship between the operator (or relevant office, where applicable) and participants;
- (6) the office(s) where activities related to the maintenance of securities accounts are being conducted;
- (7) the relevant law that applies to proprietary aspects of securities held in the systems;
- (8) the nature of the property rights with respect to securities held in the system;
- (9) rules on the transfer of securities (or interest in securities), especially concerning the moment of transfer, irrevocability and finality of transfers, also in links and interoperable systems;
- (10) information on how DvP is achieved;
- (11) rules under the applicable proprietary law in the system on securities lending, as well as rules governing the use of collateral;
- (12) rules on settlement failures, including rules relating to the possible unwinding of failed transactions;
- (13) rules under the applicable law in the system for the liquidation of positions, including the liquidation of assets transferred as collateral,
- (14) the applicable law governing the contractual relationship underpinning links and interoperable systems.

The information on financial guarantees (safeguards) protecting investors in case of insolvency of intermediaries are accessible since Compensation Scheme regulations are specified in the provisions of the Chapter V of the Act on Trading in Financial Instruments (available on the Polish Financial Supervision Authority website).

According to the Polish law KDPW S.A. cannot be declared bankrupt and is not allowed to take any credit risk of the participants on itself. Therefore, there are no specific rules concerning its default or insolvency.

### **Conflicts of laws**

KDPW S.A., due to the lack of regulations supporting omnibus accounts for foreign entities in the Polish law, has no foreign participants through links, no remote participants or participants operating directly from foreign offices. When KDPW S.A. registers foreign securities (KDPW S.A. as an “investor CSD”) the Art. 7 of the Act on Trading in Financial Instruments of 29 July 2005 (Act on TFI), which concerns ownership right in securities and the moment of transfer of this right, applies to these securities (see the Art. 7 point 6 of this Act). The application of Polish law is ensured also by the Art. 6 point 3 and 4 of this Act. However, due to the fact that the provisions of the Act on TFI are limited to the territory of Poland, the statutory regulations of the countries in question, concerning the conflicts of laws (in Poland it is the



International Private Law Act (IPL) of 4 February 2011, which came into force in May 2011) are decisive to establish the entity which can be considered as the owner of securities in relation to issuers domiciled abroad.

As regards Polish regulations, pursuant to Art. 17 point 3(7) of the IPL the acquisition and disposal of the shareholder status, as well as rights and obligations connected therewith, are subject to the law of the country where the company is domiciled. Obligations stemming from securities are subject to the law of the country of creation or issuance of the securities (Art. 31 of the IPL). Thus, the exercising of corporate actions is subject to the domicile law of an issuer. However, according to the Art. 41 of IPL, ownership (as well as other proprietary rights) and their acquisition or disposal, are subject to the law of the country where the subject of the ownership right is located. In addition, Art. 44 of IPL stipulates that the rights from securities recorded in the account kept within the securities settlement system are governed by the law of a country where this account is maintained. Taking the above into consideration, the provisions of the Art. 41 and 44 of IPL confirm that the art. 7 of the Act on TFI applies to establishing an ownership right as regards transactions in securities recorded in the account kept in the securities settlement system operated by the KDPW S.A.

The transactions concluded on the regulated market in Poland are standardized and anonymous. Hence, the choice of law is not possible in practice. As regards OTC trades in securities registered on the account kept in Poland, the Art. 7 of the Act on TFI law will still apply to acquisition and disposal of ownership regardless of the choice of law and may not be repealed.

### **System designation by relevant authorities.**

KDPW S.A. and NBP securities settlement systems have been designated by the Act on Settlement Finality in Payment and Securities Settlement Systems and the Rules of Oversight of these Systems as systems covered by the Settlement Finality Directive. The provisions of the Act apply also to other settlement systems which may be established by additional regulation issued by the Minister competent in respect with financial institutions after having heard opinions from the President of the NBP and the Polish FSA. The President of the NBP notifies the European Commission about the designated systems.

### **Promotion of harmonization**

For systemic risk purposes, the harmonization of rules is promoted in Poland to minimize discrepancies stemming from different national rules and legal frameworks. In this respect, some harmonization has been achieved by the implementation of the Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (MiFID), the Directive 98/26/EC on settlement finality in payment and securities settlement systems and of Directive 2002/47/EC on financial collateral arrangements.

KDPW S.A., as well as its legal relations with participants, are governed by the Polish law. Link agreements are governed by the appropriate foreign jurisdictions.

**RECOMMENDATION 2: TRADE CONFIRMATION AND SETTLEMENT MATCHING**  
*Confirmation of trades between direct market participants should occur as soon as possible after trade execution, but no later than trade date (T+0). Where confirmation of trades by indirect market participants (such as institutional investors) is required, it should occur as soon as possible after trade execution, preferably on T+0, but no later than T+1. Settlement instructions should be matched as soon as possible and, for settlement cycles that extend beyond T+0, this should occur no later than the day before the specified settlement date.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 2 is observed.

### **Confirmation of trades**

100% of trades between direct market participants of organized markets (regulated markets and alternative trading systems) serviced by KDPW S.A are confirmed on the trade date.

According to the WSE regulations, contract notes should be issued and submitted to exchange members for confirmation purposes immediately after each trade is made. Parties to a trade may file objections relating to these contract notes within 30 minutes. The WSE sends the final confirmed contract notes at the end of the trading day to KDPW\_CCP S.A. In the similar way, trades concluded on the regulated over the counter market operated by the BondSpot S.A are confirmed by its participants before being sent to the KDPW\_CCP S.A. In accordance with the Rules of Trading on the Regulated Market, the Management Board may cancel the executed transaction based on the application of a member who submitted an incorrect offer (error transaction). Cancellation of an error transaction may take place within 90 minutes since its execution at the latest. A cancelled transaction is considered as not executed.

There is no obligation imposed by regulators to confirm trades by indirect market participants as well as market driven system of trade confirmation does not exist in the Polish market. In the opinion of the Polish FSA and NBP lack of mandatory trade confirmations for indirect market participants does not generate the risk of situations threatening the proper functioning of the kdpw\_stream.

### **Matching of settlement instructions**

Regarding organized markets, contract notes sent by the operators of these markets to KDPW\_CCP S.A. include matched settlement data so that matching is executed on T+0 and no later than the day before the specified settlement date for settlement cycles longer than T+0.

According to the Detailed Rules of Operation of KDPW, the documents, on the basis of which the settlement of transactions concluded on a regulated market or an alternative trading system is performed, must be delivered by KDPW\_CCP S.A. before 10:30 a.m. on the intended settlement date to KDPW S.A. settlement system. These documents account for approximately 96% of all settlement instructions.

Other settlement instructions (from the OTC market) may be delivered on the day indicated as the settlement date, however, not later than the commencement on that day of the settlement session where the operations defined in those instructions may be carried out, and if these operations are to be carried out in the real-time settlement system – before the completion of the settlement of operations of a given type in the real-time settlement system.

Instructions for post-transaction settlement must also be delivered by participants before 10.30 a.m. on the intended settlement day.

With regard to OTC market and post-transaction settlement, KDPW S.A. implemented pre-matching functionality which enables early matching of instructions for the post-transaction settlement of transactions as well as matching of OTC instructions. Matching of instructions takes place on a real time basis from 6.00 a.m. to 9.00 p.m. on business days. These instructions amount to about 4% of all settlement instructions in KDPW S.A.



end of FoP settlement at 6.30 p.m.

The final DvP netting cycle is completed around 4.00 p.m. under normal circumstances.

As regards receiving the same-day settlement instructions, settlement instructions for transactions concluded on a regulated market or in an alternative trading system, for which settlement date T+0 has been indicated, may be delivered to the KDPW S.A. on the day indicated as the accounting date, not later than the opening time of the last settlement session during which settlement of this type of transactions is performed. Therefore the kdpw\_stream is opened for receiving same-day settlement instructions:

- multiple batch settlement mode: until 3.30 p.m. for DvP instructions  
Until 6.30 p.m. for FoP instructions
- real-time settlement mode: until 5.00 p.m. for DvP instructions  
Until 6.30 p.m. for FoP instructions

The Business Continuity System (BCS) for KDPW S.A. determines that a non-extendible recovery time of critical processes is 4 hours. In case of emergency the Management Board of KDPW S.A. can change the operating hours on the motion of the Corporate Security Department.

As regards cross-border settlement, transfers executed by KDPW S.A. are effected on a free of payment basis, so that settlement is independent from the operating hours of TARGET2 or other payment systems.

### **Settlement failures**

Failures in trade settlement in KDPW S.A. are not considered to be a significant source of carried risk. There are approximately 0,17% of trades by number and about 0.05% of trades by value which fail to settle on the contractual date. The average duration of fails amounts 1,5 days, whereas the daily average number of fails in trades accounts for 133 and the daily average value is 18 299 293 in Polish zlotys.

Incentives for counterparties to settle their obligations on the contractual date are provided for in the KDPW regulations. According to the KDPW Rules, the following measures for maintaining order and discipline are implemented:

- 1) reminders,
- 2) fines (up to 5000 PLN) for contravening the principles of participation in the KDPW S.A. by failing to carry out or by improperly carrying out its obligations under the participation agreement,
- 3) special fees,
- 4) the cancellation or suspension of participation in the KDPW S.A.

The special fees are charged for:

- 1) causing a suspension of settlement of a transaction executed in the organised trading or as a part of the post- transaction settlement,

- 2) each subsequent resubmission of a transaction for settlement (in case of shortage of assets for settlement of a transaction executed outside the organised trading the documents must be sent to the kdpw\_stream once again).

The risk of fails is also mitigated by the measures envisaged within the Transaction Settlement Liquidity Guarantee System which is organised by the KDPW\_CCP S.A. in co-operation with the KDPW S.A. (please see the description to Recommendation 9).

Within the KDPW\_CCP S.A. regulations it is ensured that fails are marked to market and open positions are closed out at market prices if the duration of the fail exceeds a specified number of business days. According to the KDPW\_CCP S.A. Rules, in the event that a member does not carry out measures to ensure the elimination of suspension of transaction settlement caused by the shortage of securities, or that, despite the measures undertaken by the member, settlement suspension is maintained owing to the lack of securities, on the third day after the day in which the settlement should have taken place, the KDPW\_CCP S.A. undertakes measures aimed at purchasing securities on the account of such a participant. In certain justifiable circumstances, in particular for the reasons of safety of clearing, the KDPW\_CCP S.A. may also undertake such measures at an earlier date. Concerning operation in the area of market making the KDPW\_CCP S.A. undertakes analogous actions on the fourth day after the day that settlement should have taken place.



#### **RECOMMENDATION 4: CENTRAL COUNTERPARTIES (CCPS)**

*The benefits and costs of establishing a CCP should be evaluated. Where a CCP mechanism or guarantee arrangement has been introduced, it should be assessed against the ESCB-CESR Recommendations for CCPs or against the checklist for guarantee arrangements respectively.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 4 is partly observed.

#### **Guarantee arrangement**

A guarantee arrangement has been introduced in KDPW\_CCP S.A., a clearing house being a separate legal entity owned entirely by the KDPW S.A. According to the wording of Recommendation 4, the NBP and Polish FSA note that the arrangement described in key issue 2 may fall into 3 categories, which are: guarantee arrangements (eg. Insurance arrangements), guarantee arrangements comparable to CCP and CCP. In assessors' opinion The Transaction Settlement Liquidity Guarantee System managed by the KDPW\_CCP S.A. should be classified as a guarantee arrangement comparable to CCP because of its significance, scope of performed functions and applied risk management measures. The system covers all transactions concluded by the KDPW\_CCP S.A. clearing members on the organised cash and derivatives markets. Furthermore, funds of the system comprise: participants' receivables, maintenance margins, the basic and the additional contributions to the guarantee fund provided by participants and the equity capital of the KDPW\_CCP S.A.

KDPW\_CCP S.A. has not been assessed against the ESCB-CESR Recommendations for CCPs (please see the comments).

#### **Establishment of a CCP**

The benefits and costs of transforming the guarantee mechanism into a CCP have been carefully evaluated internally within the NBP and the KDPW S.A. In particular, the NBP has analysed the rationale for establishing CCP in the Polish market and the possibility to use the CCP mechanism in the Polish legal framework. As for the KDPW S.A., several analyses were conducted internally by the CCP Project Team, including a financial analysis.

According to the Strategy for 2010-2013, which was adopted by the Supervisory Board of the KDPW S.A. in late 2009, KDPW S.A. aims to establish CCP as a separate legal entity. The Strategy was built by the KDPW S.A. on the basis of numerous consultations with the shareholders of the KDPW S.A. that are State Treasury, National Bank of Poland and the Warsaw Stock Exchange. After consultations with the Advisory Committee, it has been approved

by the Supervisory Board. As a result of the approach adopted in the Strategy, a separate legal entity – KDPW\_Clearpool had been established which acted as a guarantor so that it was obliged to provide its own capital in cases of settlement default, determined by the provisions of the KDPW regulations. Since July 2011 the KDPW\_Clearpool has become, under the name KDPW\_CCP S.A., a clearing house which manages the Transaction Settlement Liquidity Guarantee System. The System, as it took place earlier, envisages the use of the KDPW\_CCP S.A.'s own capital. After all the necessary changes in the Polish legal framework the KDPW\_CCP S.A. is to be transformed into CCP. The actions undertaken while creating and operating the KDPW\_Clearpool and then KDPW\_CCP S.A. have taken into account the ultimate goal which is establishing a CCP in order to limit the costs of the transformation to a minimum.

**Comments:**

In line with the information given above, in December 2009, the Supervisory Board of KDPW S.A. agreed that one of the major goals of KDPW is to establish CCP in the Polish market. Within the Strategy for 2010-2013, the step-by-step approach was adopted for the CCP establishment. The first step was incorporating KDPW\_Clearpool S.A. (as a transactions' settlement guarantor) in the second quarter of 2010. The next step was outsourcing clearing functions and the operation of the Transaction Settlement Liquidity Guarantee System by the KDPW S.A. to its subsidiary – KDPW\_CCP S.A. (formerly KDPW\_Clearpool S.A.) in July 2011. The final step aims at implementing CCP functionality (framework for interposing itself between the counterparties to a trade, becoming the buyer to every seller and the seller to every buyer). Currently, this is not possible due to the barriers and obstacles in the Polish law. The institutions of novation and open offer are expected to be introduced into the Polish legal framework.

Taking into account the fact that KDPW\_CCP S.A. in its current capacity was established in July 2011 and that the guarantee arrangements have been recently undergoing substantial transformation, the National Bank of Poland and the Polish FSA agreed that conducting the thorough assessment of KDPW\_CCP S.A. against the ESCB-CESR Recommendations for CCPs had been difficult to perform. The assessors also agreed that conducting the relevant assessment should be initiated after launching KDPW\_CCP S.A. operations in its current capacity. Therefore, the assessors intend to conduct the assessment of KDPW\_CCP S.A. against the ESCB-CESR Recommendations for CCPs shortly after finalization of this assessment.

## **RECOMMENDATION 5: SECURITIES LENDING**

*Securities lending and borrowing (or repurchase agreements and other economically equivalent transactions) should be encouraged as a method for avoiding settlement failures and expediting the settlement of securities. Barriers that inhibit the practice of lending securities for this purpose should be removed. The arrangements for securities lending should be sound, safe and efficient.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 5 is observed.

### **Impediments to the development and functioning of securities lending.**

Securities lending system is organized by KDPW\_CCP S.A. in cooperation with KDPW S.A. The existing legal, tax and accounting framework does not create substantial barriers to the development and functioning of securities lending. Securities lending is regulated by general rules of the Polish Civil Code. There are no legal provisions which specifically regulate this activity, other than the KDPW\_CCP and KDPW Rules.

KDPW S.A. and KDPW\_CCP S.A. regulations create sound and clear legal basis for such transactions. These regulations define the rights and obligations of parties, the principles of settlement of such transactions, the criteria according to which the lender is selected, the role of KDPW S.A. as the agent in the lending/borrowing system, the principles for establishing and maintaining the required collateral of a loan, the duration of loans, the principles for satisfying the liabilities owed to the lender from the collateral, the amount of the remuneration due to the lender etc.

### **Arrangements for the securities lending in KDPW S.A. and KDPW\_CCP S.A.**

KDPW\_CCP S.A. operates a centralised and automated facility for securities lending as well as encourages participation in bilateral securities lending. Securities lending is a part of The Transaction Settlement Liquidity Guarantee System organized by KDPW\_CCP S.A. in cooperation with KDPW S.A. thus it is used as a method to expedite securities settlement.

According to the paragraph 72 of the KDPW Rules, each direct participant of KDPW S.A. may act as a party to the securities lending and borrowing, however only the direct participant, who is a clearing member in KDPW\_CCP S.A. or is represented by a settlement agent, may act as a borrower.

In the case of the automated securities lending arrangement the securities range covers all the securities for which settlement is secured by the guarantee funds. The actual demand for lending exceeds the number of lending offers.

The cost and conditions for the use of the both types of securities lending facility are specified in the KDPW\_CCP and KDPW Rules, which are available on the website.

### **Approval of the risk management procedures by the supervisors and overseers**

According to the paragraph 72 of the KDPW Rules, parties to a securities lending and borrowing agreement are direct participants of the depository-settlement system. It implies that KDPW S.A. does not act as a principal, and thus KDPW S.A. does not take any risk in the process of securities lending.

Nonetheless, according to the Act on Trading in Financial Instruments, the KDPW\_CCP S.A. and KDPW Rules, and changes to these rules, which include regulations of the securities lending, are approved by the Polish Financial Supervision Authority after being consulted with the President of the National Bank of Poland. Polish FSA and NBP use these powers also as means to pursue implementation of its policies relating to the risk management procedures for securities lending. Also Polish FSA is entitled to order the supervisory board of KDPW S.A. to promptly adopt a resolution on a specific matter. This competence could be used in case when any significant insufficiency in securities lending is detected.

### **Risk in the process of securities lending**

According to the paragraph 72 and 73, parties to a securities lending and borrowing agreement are direct participants in the depository-settlement system. Thus KDPW S.A. does not take any risk in the process of securities lending. All the automatic lending and borrowing transactions between participants are sufficiently collateralized to mitigate the risk of problems in concluding the closing transactions. Any costs incurred by KDPW S.A. related to the service of securities lending are covered by collateral, borrower or appropriate contributions of participants to the settlement guarantee fund.

### **Debit balances and securities creation**

During the process of securities lending KDPW S.A. does not allow of debit balances in kdpw\_stream or securities creation. Client's assets are used only with the explicit consent of the lender.

It stems from the fact that, according to the KDPW Rules, KDPW S.A. is in charge of supervising the registration of securities by its participants to the extent specified in the rules and resolutions of the Management Board. As included in the description to the Recommendation 12, there are different measures used in order to avoid debit balances and securities creation.

## **RECOMMENDATION 6: CENTRAL SECURITIES DEPOSITORIES (CSDS)**

*Securities should be immobilised or dematerialised and transferred by book entry in CSDs to the greatest possible extent. To safeguard the integrity of securities issues and the interests of investors, the CSD should ensure that the issue, holding and transfer of securities are conducted in an adequate and proper manner.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 6 is observed.

### **Dematerialisation, recording and transfer of securities**

All securities registered in kdpw\_stream are dematerialised. According to the Act on Trading in Financial Instruments, securities issued as physical certificates expire at the moment of their registering in central securities depository. At the moment of registration of securities in kdpw\_stream, the physical certificates cease to exist as securities. The transfer of securities registered in kdpw\_stream occurs only in the form of book entry and does not require any form of physical delivery. Moreover, all the securities registered in other entities, which perform CSD functions in Poland, are also dematerialised and transferred in the form of book entry.

The accounting scheme for the recording and transfer of securities is determined by the KDPW Rules and resolutions of the Management Board of KDPW S.A. According to the KDPW Rules, participants managing securities accounts are obliged to conform to the rules of managing a securities register, which are determined by the abovementioned. Registration of securities is carried out as expressions of quantity, according to the following principles: 1/ double-entry book-keeping, 2/ separate registration of securities, 3/ classification by types of participant status, 4/ simultaneous registration, 5/ completeness, 6/ integrity, 7/ transparency. The best accounting practices are applied and end-to-end audit trails are kept.

The level of necessary cooperation between all the entities involved in the recording and transfer of securities is determined by the provisions of the Act on Trading in Financial Instruments. As it is defined in the Act, depository for securities means a system maintained by KDPW S.A. for registration of dematerialised securities, comprising securities accounts and deposit accounts kept by entities authorised to do so under the Act. According to the Act, KDPW S.A. is, among others, solely responsible for:

- 1) operation of the depository for securities,
- 2) supervision over whether the size of an issue registered in the depository for securities is consistent with the number of traded securities;
- 3) provision of services supporting issuers in performance of their obligations towards the holders of rights attached to securities registered in the depository for securities

In consequence KDPW S.A. is in charge of registering securities in:

- 1) deposit accounts, in the case of which the identification of the holder of the securities account in which such securities have been registered is not possible;
- 2) securities accounts.

Balances on securities accounts kept by the participants should correspond with the balance on a relevant deposit account maintained by kdpw\_stream. The global amount of the securities of a given ISIN is registered in kdpw\_stream in a registration account called an “issue account” and simultaneously in registration accounts kept for participants, according to the number of securities registered by each participant in securities accounts as well as according to the number of securities registered on securities accounts managed in kdpw\_stream.

As regards the possible implications of the time-lag between the settlement and the registration for finality<sup>1</sup>, the KDPW Rules specify that registration in the meaning of updating the ownership status on securities accounts is performed in the records managed by participants on the basis of documents confirming the registration of the operations in the kdpw\_stream on **the settlement date**.

Furthermore, pursuant to the Article 50 subparagraph 4 point 14 of the Act on Trading in Financial Instruments, the KDPW Rules stipulate, in particular, the moment of introducing of settlement orders to the settlement system and the moment when the settlement orders introduced to the system may not be cancelled from that system by the participants or third parties. Further to that, the paragraph 51b of the KDPW Rules clearly stipulates the timing of the settlement finality the main provisions of which have been outlined below.

A Settlement Order which has been introduced to the settlement system by a participant may not be cancelled from that system after it has been matched by kdpw\_stream with a Settlement Order introduced to the settlement system by the participant which is a counterparty to the settlement. However, for a transaction settled in the multibatch or real-time settlement system the Settlement Orders may be cancelled from that system after they have been matched by kdpw\_stream only on the basis of Matching Instructions delivered by the parties in order to cancel these Settlement Orders. In the case of transactions concluded on the regulated market or in an alternative trading system which are cleared by KDPW\_CCP S.A. settlement orders may be cancelled from the settlement system:

- 1) in the multibatch settlement system – no later than till the start of the settlement session during which the settlement the transaction can be started in kdpw\_stream,
- 2) in the real-time settlement system – no later than till the moment of settlement.

### **Risks involved in the KDPW S.A. operations as an entity performing CSD functions**

In accordance with the Polish legal framework, currently KDPW S.A. does not enter into any arrangements that carry credit or liquidity risks. Pursuant to the provisions of the Banking Law

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<sup>1</sup> It is understood, for the purpose of this recommendation, that timing of settlement finality is the time at which the deliveries of securities and/or cash become both irrevocable and enforceable.

and the Act on National Bank of Poland, KDPW S.A. is not allowed to hold bank accounts or hold a bank account with National Bank of Poland. This significantly limits the powers of KDPW S.A. specified in the Act on Trading in Financial Instruments which envisage that KDPW S.A. may keep cash accounts, settle payments in cash, advance loans and participate in transaction settlements conducted by the National Bank of Poland on the terms applied in inter-bank settlements to the extent it is necessary for the fulfillment of its responsibilities determined by the Act. In order to facilitate DvP settlement in central bank money in kdpw\_stream, special arrangements have been introduced in the the regulations of the National Bank of Poland, which does not imply that powers of KDPW S.A. are adequate to the powers of licensed banking institutions.

In case of kdpw\_stream's operations any liquidity or credit risks may only result from conducting a net settlement system. To minimize these risks, KDPW\_CCP S.A., a separate legal entity to which KDPW S.A. has outsourced its clearing functions, organizes in co-operation with KDPW S.A. the Transaction Settlement Liquidity Guarantee System. The system arrangements have been outlined in the description to the assessment against Recommendation 9. Securities lending and borrowing system, which poses a part of the Transaction Settlement Liquidity Guarantee System, meets the requirements included in Recommendation 5. It should be noted that KDPW S.A. does not act as a principal during the process of securities lending and all the automatic lending and borrowing transactions between participants are sufficiently collateralized. With regard to cash settlement any risks are duly minimized as central bank money is used and the interfaced model has been applied. Other requirements, which are indicated in Recommendation 10 are considered to be met.



## **RECOMMENDATION 7: DELIVERY VERSUS PAYMENT (DVP)**

*Principal risk should be eliminated by linking securities transfers to fund transfers in a way that achieves delivery versus payment.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 7 is observed.

### **Legal, contractual and functional DVP framework.**

The technical, legal and contractual framework ensures that the Delivery versus Payment (DvP) principle is implemented in the process of securities settlement in kdpw\_stream.

According to the classification of the Bank for International Settlements (BIS), the kdpw\_stream supports the following DvP models:

- Model 1 (Gross settlement in securities and funds transfers) - for real-time settlement mode
- Model 2 (Gross settlement of securities transfers followed by net settlement of funds transfers) - for multiple batch settlement mode.

All transactions settled in kdpw\_stream, concluded within the organised market (regulated and alternative trading facilities), are subject to mandatory DvP settlement. Transactions concluded outside of the organised market, which are settled on a FoP basis account for 0.3% of all the transactions settled in kdpw\_stream.

The Legal and contractual basis that ensures DvP principle is stated by the internal regulations. Paragraph 52 of the KDPW Rules states that the cash deposit account of a participant that is a party to settlement shall be credited simultaneously with the recording of the securities sale in the registration account kept for that participant in the kdpw\_stream. The cash deposit account of a participant that is a party to settlement shall be debited simultaneously with the recording of the securities purchase in the registration account kept for that participant in the kdpw\_stream.

### **Technical DvP framework**

The technical functionality of the kdpw\_stream ensures that the cash and securities legs of the transaction are processed simultaneously. The underlying securities are blocked in the securities account of the seller in the kdpw\_stream. Then the kdpw\_stream automatically triggers requests for transfer of funds from the buyer's cash account, through the KDPW's technical account, to the seller's cash account. After receiving the settlement confirmation of the cash leg from the National Bank of Poland, the kdpw\_stream transfers the securities to the buyer's securities account. The National Bank of Poland ensures sound and effective electronic connection between the kdpw\_stream and RTGS system.

The length of time between the blocking of securities and cash payment and the moment when deliveries become final is minimized. In DvP Model 1 (real time settlement mode) the time-lag between the completion of the blocking of securities and the final settlement takes a couple of seconds while in DvP Model 2 (multiple batch settlement mode) it ranges from 10 minutes to 15 minutes.

## **RECOMMENDATION 8: TIMING OF SETTLEMENT FINALITY**

*Intraday settlement finality should be provided through real-time and/or multiple-batch processing in order to reduce risks and allow effective settlement across systems.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 8 is observed.

### **Timing of settlement finality**

During the settlement day, the system operated by the KDPW S.A. permits final settlement of securities transfers on a DvP and FoP basis. Settlement on a DvD basis does not provided by kdpw\_stream.

Regarding legal framework support for timing of settlement finality, pursuant to the Article 50 subparagraph 4 point 14 of the Act on Trading in Financial Instruments, the KDPW Rules stipulate, in particular, the moment of introducing of settlement orders to the settlement system and the moment when the settlement orders introduced to the system may not be cancelled from that system by the participants or third parties. Further to that, the paragraph 51b of the KDPW Rules clearly stipulates the timing of the settlement finality. Pursuant to the provisions of this paragraph, the unilateral revocation of matched settlement instructions is prohibited. The settlement instructions introduced to the depository-settlement system by a participant may not be cancelled from the moment the kdpw\_stream has determined that the settlement instruction matches with the corresponding document introduced by the settlement counterparty. The settlement instructions for transactions concluded in the organized trading, and introduced to the depository-settlement system by KDPW\_CCP S.A., which have been already matched, could be revoked by this entity. Though, it should not be considered as an unilateral cancellation because KDPW\_CCP S.A. acts on the basis of Power of Attorney on behalf of its participants (please also see the description to Recommendation 6).

After the transfer orders become final, i.e. irrevocable and unconditional in the system, the final balances resulting from settlement of the transfer orders are unconditionally registered on deposit accounts in kdpw\_stream and on securities accounts in participants registers on the same day. These balances are irrevocable.

With respect to cross-border links, the timing of settlement finality is supported by relevant regulations based on Settlement Finality Directive of issuer CSD and laws of the issuer country. The kdpw\_stream does not receive provisional transfers of securities from any other systems.

KDPW S.A. has free of payment unilateral links with other securities settlement systems and acts as an investor CSD for the cross-border transfers of securities via these links.

### **Settlement finality and settlement modes in kdpw\_stream**

Kdpw\_stream provides final settlement of transfers on a real-time basis and through multiple-batch processing during the settlement day.

According to the Detailed Rules of Operation of KDPW, the operating hours of the multiple-batch settlement mode are as follows:

- start (technical session) at 7.30 a.m.
- first multiple batch at 10.30 a.m. with payments
- second multiple batch at 1 p.m. with payments
- third multiple batch at 3.30 p.m. with payments
- last multiple batch at 6.30 p.m. without payments.

Each batch lasts about one hour. As described above, the last multiple batch with payments starts at 3.30. p.m. This means that it takes place 2.5 hours before the closing of the payment system operated by the National Bank of Poland.

The transfer of securities through the system links is done on a real-time gross basis, so that securities transferred through each of the system's links can be reused by the recipients during the day.

### **Promotion of early settlement**

In practice, transactions concluded in the organized market are settled mainly on the first dedicated session during the day at 10.30 a.m. Kdpw\_stream does not experience problems in settlement due to participants delays. If for some reasons the settlement of some transactions does not take place during the first batch, the settlement is postponed to the next batches at 1:00 p.m. or 3:30 p.m.

However, there are incentives used for maintaining order and discipline. According to the KDPW Rules, there are used the following measures:

- 1) reminders,
- 2) fines (up to 5000 PLN) for contravening the rules of participation in the kdpw\_stream by failing to carry out or by improperly carrying out its obligations under the participation agreement,
- 3) special fees,
- 4) the cancellation or suspension of participation in the kdpw\_stream.

The special fees are charged for:

- 1) causing a suspension of settlement of a transaction executed in the organised trading or as a part of the post- transaction settlement,

- 2) each subsequent resubmission of a transaction for settlement (in case of shortage of assets for settlement of a transaction executed outside the organised trading the documents must be sent to the kdpw\_stream once again.

**RECOMMENDATION 9: CSD RISK CONTROLS TO ADDRESS PARTICIPANTS' FAILURES TO SETTLE**

*CSDs that extend intraday credit to participants, including CSDs that operate net settlement systems, should institute risk controls that, as a minimum, ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle. The most reliable set of controls is a combination of collateral requirements and limits.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 9 is observed.

**CSD risk controls**

Kdpw\_stream provides risk controls related solely to the net settlement. Intraday credit is not extended to its participants.

In accordance with the KDPW\_CCP Rules and KDPW Rules, KDPW\_CCP S.A. in co-operation with KDPW S.A. organizes the Transaction Settlement Liquidity Guarantee System which ensures that timely settlement can be completed in the event of an inability to settle by the participant with the largest obligation.

The major measures of the Transaction Settlement Liquidity Guarantee System are:

- 1) operating settlement guarantee fund,
- 2) acting as an intermediary in both: the arranged and the automated securities lending by offering a centralised facility,
- 3) lending/borrowing transactions on a bilateral basis between participants,
- 4) using the capital of the KDPW\_CCP S.A. – which is a separate legal entity owned by KDPW S.A.

The assets of the system are: the receivables of the participant, maintenance margins, basic and additional contributions to the relevant parts of the guarantee fund and the own capital of the KDPW\_CCP S.A. These funds are kept on fixed-term bank deposit accounts and debt instruments of high liquidity, which shall guarantee getting liquid assets at least in the next day of shortage. Participants are not able to call for its assets contribution to the settlement guarantee fund during the duration of the contractual relationship with KDPW\_CCP S.A.

In line with the given above, KDPW\_CCP S.A. in co-operation with KDPW S.A. manages an automatic securities lending and borrowing system for its participants to prevent or eliminate suspension of settlement of transactions secured by the Settlement Guarantee Fund. Within the framework of the securities lending and borrowing it is ensured that KDPW S.A. does not act as a

principal. All exposures resulting from lending of securities are fully collateralised. There are limits imposed on the number of securities admitted to lending - the total number of loaned securities with the specific securities ISIN code number may not exceed 5% of the total issue for a single borrower and 10% of the total issue for all borrowers taken together.

Until now, all the cases of participants' failures have been resolved without using the assets of the Settlement Guarantee Fund or the own capital of the KDPW\_CCP S.A.

### **Measures to avoid debit balances and securities creation**

Pursuant to the KDPW Rules, KDPW S.A. supervises the registration of securities by its participants to the extent specified in the rules and resolutions of the Management Board. According to this, the following measures to avoid debit balances and securities creation are implemented in the Detailed Rules of Operation. Securities that have been purchased or sold without a client's order shall be registered in the participant's records on offsetting accounts used to register operations that are deemed to contain errors. Securities sold but not registered on the settlement date in the securities account held for the client placing the order for the sale transaction shall also be registered on offsetting accounts. A securities sale transaction shall be a transaction concluded on the seller's account. Participants should make every effort to eliminate securities positions in offsetting accounts as soon as possible. To check the compliance of participant's operation with these measures, participants are obliged to deliver to KDPW S.A., on a monthly basis, information indicating those sale transactions executed by them without a client order or those whose details do not correspond to a correct client order, settlement of which leads to a temporary divergence between the balances on the registration accounts managed for the participant by the kdpw\_stream and the balances on the corresponding securities accounts. Participants are also obliged to provide information indicating how such discrepancies are to be corrected.

### **Multiple failures**

Since KDPW\_CCP S.A. has become responsible for organizing and managing the Transaction Settlement Guarantee System, it continues to evaluate the cost and probability of ensuring settlement in the event of multiple failures usually several times a year during performance of stress-tests. Recently, stress tests were carried out in April 2011. Due to the fact that the resources of the Settlement Guarantee Fund are built on the basis of the largest credit exposure on the market, settlement cannot be completed in the event of multiple failures unless the value of multiple failures of transaction settlement does not exceed the value of potential failure of transactions settlement for the largest participant.



#### **RECOMMENDATION 10: CASH SETTLEMENT ASSETS**

*Assets used to settle payment obligations arising from securities transactions should carry little or no credit or liquidity risk. If central bank money is not used, steps must be taken to protect the participants in the system from potential losses and liquidity pressures arising from the failure of the cash settlement agent whose assets are used for that purpose.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 10 is observed.

#### **The use of central bank money**

For transactions denominated in PLN (Polish zloty) the cash payment is settled in central bank money. Settlement of these transactions is carried out in the money of National Bank of Poland through the SORBNET system. There is also a possibility to settle transactions denominated in EUR in central bank money. Kdpw\_stream does not settle cross-border transactions, however it processes cross-border free of payment transfers of securities, acting as the investor CSD.

The National Bank of Poland's SORBNET system which is used to interbank transfers among settlement banks observes the CPSIPS. The NBP, according to responsibility B of the Central Bank in applying CPSIPS as operator and owner of its systems, ensures compliance of SORBNET with CPSIPS. The last full assessment of SORBNET was performed in 2002. Any significant modifications implemented in SORBNET are evaluated from the CPSIPS perspective. There is no cash leg settlement in foreign currency. KDPW's payments in euro are settled in the SORBNET-EURO system operated by the National Bank of Poland and comprise only: (i) dividends sent by foreign banks on behalf of Polish banks, KDPW S.A.'s fees (for participation in PHA), funds transfers from commercial banks on behalf of the KDPW S.A. that enable the KDPW S.A. to pay fees.

Costs and conditions for the use of central bank money are subject to bilateral agreements between kdpw\_stream settlement participants and financial institutions acting as their settlement banks.

#### **Settlement banks**

As it was indicated earlier, cash settlement is performed in the central bank money through the SORBNET payment system operated by the National Bank of Poland. Participants of the kdpw\_stream are represented by settlement banks which, in accordance with the Resolution No 14/2000 of the Management Board of the NBP of 31 March 2000 on terms for opening and maintaining banks' accounts with the NBP, are allowed to be participants of the SORBNET payment system. These are domestic banks, branches of banks domiciled outside the European

Union and branches of credit institutions which are entities licensed by the Polish Financial Supervision Authority or other government authorities of the EU, respectively.

Pursuant to the Resolution, NBP opens a bank's current account in Polish zloty in SORBNET system if:

- 1) the bank has been conducting operational activities for at least 6 months prior to submitting the application,
- 2) financial standing of the bank is considered by the NBP as appropriate,
- 3) the bank meets technical requirements enabling electronic exchange of messages with payment orders and other information between the bank and the NBP.

The procedure of opening a bank account in NBP also envisages the consultation process with the Polish Financial Supervision Authority in terms of, inter alia, financial standing and observing requirements related to risk carried by the bank.

NBP aims at mitigation of systemic risk in Polish payment systems. Therefore, NBP oversees SORBNET system. SORBNET is monitored, on a regular basis. Also, functioning of the system, in terms of interconnections with, among others, securities settlement systems is evaluated. As regards financial stability concerns, NBP regularly monitors the condition of the Polish financial system, including financial condition of the settlement banks, and evaluates the necessity of undertaking appropriate measures.

Currently, there are 42 settlement banks registered with kdpw\_stream, out of which 25 banks can be considered active on a daily basis.

### **Availability of the proceeds of securities settlements**

Participants of the kdpw\_stream receive confirmation of the settled transactions intraday, immediately after completion of each settlement batch and in real-time for settlement transactions in the real-time mode.

According to the Detailed Rules of Operation, kdpw\_stream issues statements of a registration account without delay when any operation is registered on the account. In addition, kdpw\_stream issues to participants summary statements for a given accounting date at the end of that day and makes available information on the status of the documents introduced into the depository-settlement system.

In addition, the provisions of the Detailed Rules of Operation determine that at the date of the transaction settlement in kdpw\_stream, participants make entries on individual securities holding accounts on the basis of registration account statements, summary statements for a given accounting date or information on the status of a settlement instruction confirming that settlement took place according to the instruction.

### **RECOMMENDATION 11: OPERATIONAL RISK**

*Sources of operational risk arising in the clearing and settlement process should be identified, monitored and regularly assessed. This risk should be minimalised through the development of appropriate systems and effective controls and procedures. Systems and related functions should (i) be reliable and secure, (ii) be based on sound technical solutions, (iii) be developed and maintained in accordance with proven procedures, (iv) have adequate, scalable capacity, (v) have appropriate business continuity and disaster recovery plans that allow for the timely recovery of operations, and (vi) be subject to frequent and independent audits.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 11 is observed.

The following description, relating to the Operational Risk Management Model, refers to the whole KDPW S.A. capital group. The Model, which also encompasses the Business Continuity System, has been implemented in KDPW S.A., as well as in KDPW\_CCP S.A.

#### **Operational risk management framework**

KDPW S.A. has implemented an Operational Risk Management Model. Within this model KDPW S.A. regularly identifies, measures, monitors and manages operational risk in all the business activities. The risk level measurement takes place every 4 months.

Identification and measuring of operational risk is carried out in a 3-dimensional space (business process, risk factor, organisational unit) for which operational risk level in terms of frequency and severity is estimated. The full risk level measurements are made every 4 months. At least once a year there are also conducted measurements of potential financial losses and information security. For measuring, monitoring and managing the operational risk there are intranet-based tools used for supporting mechanisms of risk measurements, disclosure of the measurement results, Event Register, Threat Register, and covering issues of information security in kdpw\_stream.

In order to transfer part of the operational risk KDPW S.A. has concluded an operational risk liability insurance agreement for 100 mln PLN covering KDPW S.A. and KDPW\_CCP S.A.

#### **Operational risk policies and procedures**

Operational risk policies and procedures have been clearly defined. They are reviewed, updated and tested - according to the Model in force - at least once a year or after each business process change.

The directors of organisational units are responsible for direct management of operational risk in business processes realised by these units, according to the areas of responsibility defined in the Model. A member of the Management Board and directors of the operations departments constitute the Operational Risk Committee which is responsible for coordinating all activities in the operational risk management process. The Committee, which is supported by the Corporate Security Department, reports to the Management Board. The Committee meets at least once every 4 months. The Management Board defines the Risk Management Policy, accepts the Committee reports on operational risk in KDPW S.A. and makes managerial decisions as proposed by the Committee.

The IT systems and processes are regularly audited by internal services (Internal Audit Department and Security Department) and by an external auditor. They were also subject to an insurance audit.

### **Business continuity and disaster recovery plans**

KDPW S.A., as the system operator, has implemented contingency plans and disaster recovery plans called the Business Continuity System (the BCS). The BCS defines all procedures for business processes (operational procedures and recovery procedures) and provides resources to ensure the system operator resumes all its core business activities as soon as possible after the disruption occurs (systems' failure or resources disruption, e.g. the primary site). Business processes have been categorised accordingly to their criticality. The maximum reactivation time for the core business (critical) processes is 4 hours while other processes are to be reactivated till the next business day.

Within the BCS KDPW S.A. operates a second processing site which is located outside of Warsaw, in 20 km distance. The both sites are connected by a private fibre cable. The BCS provides the basis for the recovery of all transactions at the time of the disruption - all transactions entered into the system are replicated on line to the backup systems located in the secondary site before confirming them to the clients, and can be carried out after resuming operational activities in the secondary site. Additionally, at the end of each business day all data are backed up. Integrity of messages ensures digital signature, based on the X.509 certificates. kdpw\_stream ensures sufficient flow of information in order to establish and maintain an effective operational risk management framework. Service Level Agreements have been implemented in relations with IT services providers.

The BCS includes crisis management structures, formal procedures, identified personnel, alternative means of communication and contact lists. In the case of disruption the Crisis Management Board is activated. The Board is responsible for coordination of all the activities to reactivate the business processes. Additionally, a Recovery Group and an Operations Group have been defined which are responsible for preparing backup systems and backup location, and resuming of the business activities, respectively

Business continuity external tests with all the depository participants are conducted at least once a year. An internal test is carried out twice a year, and after each significant system modification (software or hardware).

The abstract from the BCS Master Document is publicly accessible via the KDPW S.A. website: [http://www.kdpw.pl/en/kdpw/Documents/szcf\\_e\\_kdpw.pdf](http://www.kdpw.pl/en/kdpw/Documents/szcf_e_kdpw.pdf)

### **System failure and stress volume tests**

There was no failure of a key system in the last year. Stress tests of the key systems are conducted after each software or hardware significant change.

The capacity of the system was designed with a significant surplus. The standard daily operations use only about 5-10% of maximal settled volumes of transactions. The only stressful conditions of the system occur very occasionally during large mass privatisation IPO's that are processed in parallel to the daily clearing and settlement of transactions concluded on the secondary markets.

### **Outsourcing of CSD functions**

Upon the authorisation provided for in the Article 48 of the Act on Trading in Financial Instruments, KDPW S.A. delegated its clearing functions, including its responsibilities related to the Transaction Settlement Liquidity Guarantee System, to KDPW\_CCP S.A.

KDPW\_CCP S.A., as well as any other entity to which KDPW S.A. may outsource its core functions, is subjected respectively to Polish FSA and the NBP's supervision and oversight. In particular, the KDPW\_CCP S.A. Rules or the guarantee fund managed by KDPW\_CCP S.A. are subject to the approval of the Polish FSA after being consulted with the NBP.

According to the Act, KDPW S.A. is obliged to outsource its functions on the basis of a written contract which shall be notified to the Polish FSA. The Polish FSA is not authorised to cancel the agreement, however there are other supervisory means at the disposal of the Polish FSA which ensure the proper supervision of the KDPW\_CCP S.A. In particular, the Polish FSA may order the supervisory board of KDPW S.A. to promptly, and in any case no later than within ten business days, adopt a resolution on a specific matter.

The powers of KDPW S.A. in terms of change management with relation to the outsourced services result from the governance arrangements. Since the KDPW\_CCP S.A. is the subsidiary company of KDPW S.A., the KDPW S.A. may require, control and approve changes to services to be rendered by KDPW\_CCP S.A. Furthermore, the Management Board of KDPW\_CCP S.A. is composed of the persons who are the members of the Management Board of KDPW S.A.

## **RECOMMENDATION 12: PROTECTION OF CUSTOMERS' SECURITIES**

*Entities holding securities in custody should employ accounting practices and safekeeping procedures that fully protect customers' securities. It is essential that customers' securities be protected against the claims of the creditors of all entities involved in the custody chain.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and the Polish FSA, Recommendation 12 is observed.

### **Arrangements used to protect customer securities**

In the Polish capital market the arrangements which are used to protect customer securities from theft, loss or misuse are based upon the Act on Trading in Financial Instruments, the Regulation of 20 November 2009 of the Minister of Finance related to the procedures and conditions to be followed by investment firms and custodian banks in the course of their activities and upon the KDPW Rules. The following arrangements are used to protect customer securities:

- KDPW S.A. maintains records that identify the assets of each participant and segregate the participant's own assets from the assets of their clients – segregation occurs by separately designated participant accounts, according to the principle of classification by types of participant status (§ 36.4 of the KDPW Rules);
- in case of suspension of a kdpw\_stream participant, the Polish FSA may take a decision to transfer securities from the accounts managed by this participant to another participant (who gave its consent to it), where they are immediately accessible to the clients;
- in case of an investment's firm bankruptcy and also in case of opening a liquidation proceeding of an investment firm, the Polish FSA may order that transfer of securities, other broker-traded financial instruments and any cash and documents related to the keeping of securities accounts and cash accounts be transferred to another investment firm, subject to that firm's prior consent;
- investment firms keeping securities accounts for their customers are required to segregate assets held for their own benefit from those held for their clients and segregate assets per each client; firm may not use, on its own account or the account of a third party, the financial instruments belonging to its clients;
- a compensation scheme has been established to ensure the payments of cash to investors up to the statutorily defined level and a compensation for the value of the lost financial instruments, accumulated by such investors in brokerage houses, including their branches outside of Poland, in connection with services provided to these investors, in the event that a brokerage house is declared bankrupt, or a bankruptcy petition is dismissed by virtue of a final decision on the grounds that the assets of the brokerage house are insufficient to cover the costs of the proceedings, or the Polish FSA ascertains that due to reasons closely related to the financial standing of the brokerage house, the brokerage house is, and will continue to be in the near future, unable to fulfill its obligations under investors' claims.



Pursuant to the KDPW Rules, based on the Article 50 of the Act on Trading in Financial Instruments, the following accounting principles should be adopted by participants: simultaneous registration, completeness, integrity and transparency. These principles ensure that records should both clearly and unequivocally reflect the securities holdings of persons entitled to them at any time.

### **Reconciliation records**

Entities allowed to hold securities in custody in Poland are obliged to reconcile their records only with the central securities depository as the Polish law encourages two-tier holding structure.

KDPW S.A. supervises the registration of securities by its participants to the extent specified in the rules and resolutions of the Management Board, including, inter alia, rules according to which entries on securities accounts managed by participants should be made. The supervision is carried out, inter alia, by way of analysing daily reports showing consolidated securities holdings arising from the register managed by participants.

One of the principles included in the KDPW Rules is the principle of simultaneous registration which means that operations relating to securities need to be registered on securities accounts managed by participants on the day these operations are registered on the appropriate registration accounts managed for the participant in the kdpw\_stream, on the basis of documents confirming their registration on these registration accounts.

According to the paragraph 20 of the Detailed Rules of Operation, the securities registration procedures performed by participants shall ensure that individual balances arising from entries in securities accounts managed by those participants may be consolidated to the level of the corresponding entity accounts managed for those participants in the kdpw\_stream. Information on individual balances consolidated in this manner shall be sent by participants to the kdpw\_stream without due delay following the close of each accounting day, not later however than 10.00 a.m. on the following accounting day, in the form of a daily report.

In addition, if any discrepancy occurs between the balance in the registration accounts kept in the KDPW S.A. for a participant and the balance on the account kept by the participant for registering its own or its clients' securities, the participant is obliged to immediately take appropriate action to eliminate the discrepancy.

### **Segregation of the customer's assets**

The segregation of securities is adequately supported by the Polish legal framework. Pursuant to the paragraph 27 of the Regulation of 20 November 2009 of the Minister of Finance related to the procedures and conditions to be followed by investment firms and custodian banks in the course of their activities, investment firms maintaining securities accounts for their clients are required to segregate their assets and also segregate assets held for their own benefit from



those held for their clients. Pursuant to the paragraph 28 of this Regulation, investment firms may not use, on their own account or on the account of a third party, financial instruments belonging to their clients.

### **Auditing books provided by entities holding securities**

Pursuant to the Article 57(2) of the Act on Trading in Financial Instruments, balances on securities accounts kept by kdpw\_stream participants should correspond with the balance on a relevant deposit account kept by kdpw\_stream.

Further to that, the KDPW Rules introduced the simultaneous registration principle, which means that operations relating to securities need to be registered on securities accounts managed by participants on the day these operations are registered on the appropriate registration accounts managed for the participant in kdpw\_stream, on the basis of documents confirming their registration on these registration accounts. The Detailed Rules of Operation of KDPW state that at the end of every accounting day, the balances on securities accounts managed by participants need to correspond to the balances on the entity accounts managed for those participants by kdpw\_stream. In addition, the securities registration procedures performed by participants should ensure the aggregation of that individual balances, arising from entries in securities accounts managed by those participants, to the balances of the deposit accounts managed for those participants in kdpw\_stream. Information on individual balances consolidated in this manner should be sent by participants to kdpw\_stream in the form of a daily report following the close of each accounting day, however no later however than 10.00 a.m. on the following accounting day.

KDPW S.A. shall have the right to audit its participants and submits audits reports to the Polish FSA. Additionally, pursuant to Art. 54 (1) of the Act on Trading in Financial Instruments, KDPW S.A. may receive from the participants identification details of such participants' customers holding rights attached to specific securities and information on the number of securities held by such customers for the time being, and KDPW S.A. may demand that a participant provide it with such details and information.

The entities holding securities in custody are subject to supervision and oversight of the Polish FSA, which is authorized to make audits in the scope of the safety of the held securities.

### **Procedures prohibiting debit balances or securities creation**

KDPW S.A. supervises the registration of securities by its participants as regards the security of the registration system and the proceeding of participants in special situations that prohibit debit balances and securities creation. KDPW S.A. has provided procedures for situations in which securities have been sold without a client's order or for the securities sold but not registered on the settlement date in the securities account.

In order to maintain discipline in meeting these procedures participants are obliged to provide to KDPW S.A. information indicating the sale transactions executed without a client order or whose details do not correspond to a correct client order) on a monthly basis (§ 30a of the KDPW Rules).

### **Intermediaries**

Currently the Polish law encourages two-tier holding structure. According to the Act on Trading in Financial Instruments, this structure looks as follows:

- 1) kdpw\_stream holds securities accounts and deposit accounts, in the case of which identification of the holder of the securities account in which such securities have been registered is not possible;
- 2) securities accounts kept by the entities allowed according to the Act which correspond with the balance on a relevant deposit account maintained in kdpw\_stream. These securities accounts must allow for identification of the holder of the rights attached to securities.

In consequence the Polish law does not envisage holding securities through the chain of several intermediaries.

### **Supervision over the entities holding securities**

In Poland entities holding securities in custody are subject to prudential supervision and regulation performed by the Polish FSA. The Authority aims to ensure regular operation of financial market, its stability, security and transparency, confidence in the financial market, as well as to ensure that the interests of market actors are protected.

The entities in question are also supervised by KDPW S.A. According to the KDPW Rules, the participation in kdpw\_stream is subject to the conditions relating to the material and technical requirements, and financial requirements in case of candidates for clearing members determined by the Rules, in addition to the requirements specified by the Polish law.

Pursuant to the Act on Trading in Financial Instruments KDPW S.A. is in charge of supervision over whether the size of an issue registered in the securities depository is consistent with to the number of traded securities. Therefore, KDPW S.A. also supervises the registration of securities by its participants to the extent specified in the KDPW Rules and resolutions of the Management Board.

### **RECOMMENDATION 13: GOVERNANCE**

*Governance arrangements for CSDs should be designed to fulfil public interest requirements and to promote the objectives of owners and relevant market participants.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 13 is observed.

The KDPW S.A. is a joint stock company. Its shareholders are the State Treasury, the National Bank of Poland and the Warsaw Stock Exchange.

The governance arrangements of the KDPW S.A. are, in particular, determined by the Act on Trading in Financial Instruments. Pursuant to the provisions of the Act:

- 1) the range of entities being allowed to shareholding in the KDPW S.A. include: entities operating regulated markets, investment firms, State Treasury, National Bank of Poland, international financial institutions in which Poland is a member, entities providing post-trade services with the premises in UE or OECD countries,
- 2) matters related to the National Depository directors' reports, business plans and financial plans, reports of the operation of the compensation scheme, the KDPW Rules, settlement guarantee fund, compensation scheme and other regulations issued by the National Depository on the basis of such rules shall be consulted with Advisory Committee. It is composed of representatives of: market intermediaries, market operators, issuers, participants of securities settlement system operated by KDPW S.A. being foreign entities and associations of these entities
- 3) the Supervisory Board passes the KDPW Rules and its changes on application of the Management Board and scope of matters to be specified in the KDPW Rules,
- 4) the Polish Financial Supervisory Authority approves the KDPW Rules and its changes after being consulted with the President of the National Bank of Poland.

In line with the given above and the Commercial Companies Code (Journal of Laws of 2000, No 94, item 1037), the governance arrangements are specified in the Articles of Association of KDPW S.A. (the Statute). The Statute determines the corporate bodies' arrangements, including their responsibilities within the company and the range of decisions they are authorised to take.

#### **Composition and responsibilities of the governance bodies**

In accordance with the Statute, the Supervisory Board shall comprise six to nine members appointed and dismissed by the Shareholders' General Meeting. It is appointed for a 3-year term. The Supervisory Board may delegate members of the Supervisory Board to temporarily carry out

the duties of members of the Management Board in instances where these have been dismissed, have resigned, or for any other reason are unable to carry out their duties. Currently, the Supervisory Board is composed of 2 delegates per each shareholder.

The Management Board shall comprise three to five members. The Shareholders' General Meeting appoints and dismisses the President of the Management Board. The remaining members of the Management Board, including one or several Management Board Vice-Presidents, are appointed by the Supervisory Board at the request of the President of the Management Board. Members of the Management Board may be dismissed by the Supervisory Board. The Management Board is appointed for a 3-year term.

According to the Statute, the Shareholders' General Meeting, in particular: (i) reviews and approves the report of the Management Board on the running of the Company, as well as the financial reports, (ii) endorses the Governors of the Company in the exercise of their duties, (iii) reviews and approves the report of the Supervisory Board on its activities. As regards the Supervisory Board, its main responsibility is to continuously monitor the activities of the Company.

According to article 382 § 1 of the Commercial Companies Code, „The supervisory board shall exercise day-to-day supervision over the performance of the company in all areas of the company's activities.”. The responsibilities of the Supervisory Board include, inter alia: (i) reviewing financial statements, (ii) reviewing reports of the Management Board, as well as its recommendations on the division of profits or covering of losses, (iii) reporting in writing at the Shareholders' General Meeting on the work carried out by the Supervisory Board, (iv) approving the Rules of the National Depository for Securities and some other regulations pertaining to the duties of the Company, (v) setting the salary levels of the members of the Management Board, with the exception of the salary of the President of the Management Board, (vi) approving annual Company business plans, or Company business plans over several years presented by the Management Board, (vii) approving annual Company financial plans, or Company financial plans over several years, presented by the Management Board.

The Management Board oversees the affairs of the Company, manages its assets and represents the Company externally. The responsibilities of the Management Board include, in particular, preparing a draft of the KDPW Rules, the Rules of the Supervisory Board, the Rules of the Court of Arbitration, as well as preparing drafts and adopting regulations governing the detailed operations of the kdpw\_stream.

#### **Arrangements relating to the management expertise, experience and incentives of members of the governance bodies and other managers of KDPW S.A.**

The shareholders of the KDPW S.A., which are the State Treasury, the National Bank of Poland and the Warsaw Stock Exchange, ensure that members of the Supervisory Board have appropriate level of expertise and experience. The members of the Supervisory Board, who are appointed by the Shareholder' General Meeting, comprise the senior managers in the

shareholding. The recruitment process is determined by relevant internal procedures of the institutions delegating its representatives. The Supervisory Board is accountable for its performance to the Shareholder' General Meeting as the former is obliged to report in writing on its activities on an annual basis. The monthly salary of the members of the Supervisory Board is defined by the Shareholders' General Meeting. The Shareholders' General Meeting may award bonus payments from Company profits to the members of the Supervisory Board.

The President of the Management Board is appointed by the Shareholders' General Meeting while the members of the Management Board are appointed by the Supervisory Board on the request of the President. Prior to the appointment of the President and the members of the Management Board, candidates are selected on the basis of their education, professional experience and their vision of the company's future development. The salary levels and the conditions for the payment of bonuses from Company profits for members of the Management Board are determined by the Supervisory Board. However, the salary of the President of the Management Board is set by the Shareholder's General Meeting. The members of the Management Board are accountable for the exercise of their duties to the Shareholder's General Meeting which annually endorses their performance. They are also overseen by the President.

The management is accountable for the exercise of their duties to the Management Board. There is an electronic system of HR assessment elaborated with external consultants, which applies to all the KDPW S.A. employees, including directors (management). The formal assessment process is done twice a year for evaluation of tasks performed by all employees. For each half of the year individual tasks for each employee resulting from the operations of KDPW S.A. and strategy are formulated and agreed at the beginning of the assessment period. Moreover, once a year competences (depending on the formal position of the employee in the organisation) by their superiors as well as early agreed goals related to development of personal skills are assessed. The HR assessment is a basis for granting bonuses on a semi-annual basis. Besides the formal and strict assessment concerning operational activities, there are additional bonuses granted twice a year for those employees which have achieved special results while conducting strategic projects. The results are evaluated at the discretion of the Management Boards according to the proposal of project managers.

### **The interest of shareholders, users and the public interest**

The governance arrangements implemented in the KDPW S.A., as outlined above, provide for that the interests of the shareholders, users, as well as the public interest are taken into account by the members of the KDPW S.A. governance bodies. In particular, the public interest is reflected in the operations of the KDPW S.A. through the structure of the KDPW S.A.'s ownership as the majority of the shares are held by the State Treasury and the National Bank of Poland. In consequence, the representatives of these institutions are appointed to the Supervisory Board. In order to ensure that the users' interests are duly represented, there is the statutory obligation to consult Advisory Committee in the range of matters outlined earlier. The decision-making process in terms of major goals of the KDPW S.A. has been described below.

The vision and the strategic goals of KDPW S.A. have been articulated in its corporate Strategy for 2010-2013. The Strategy was built by KDPW S.A. on the basis of numerous consultations with the shareholders of the KDPW S.A. After consultations with the Advisory Committee, it has been approved by the Supervisory Board. The strategy is updated by the Supervisory Board on an annual basis.

The Supervisory Board also approves, after consultation with the Advisory Committee, business and financial plans for the KDPW S.A.

As a result of the Strategy, and business and financial plans, KDPW S.A. conducts projects in co-operation with market participants.

In addition to the abovementioned, market participants and the public influence functioning of the kdpw\_stream by introducing changes to the KDPW Rules. The Supervisory Board passes the KDPW Rules and its changes on application of the Management Board after consultation with Advisory Committee. Then the Polish Financial Supervisory Authority approves the KDPW Rules and its changes after being consulted with the President of the National Bank of Poland.

The Advisory Committee is also consulted as regards changes of other KDPW S.A. regulations.

In order to ensure that all the interests are duly represented in the corporate bodies of KDPW S.A. the Supervisory Board, on the application of the Management Board, and the General Meeting of KDPW S.A.'s shareholders adopted the best practices in public companies which have been drafted by public and market institutions. Specifically, these practices foresee that:

- 1) A supervisory board member should inform the other members of the board of any conflict of interest that arises, and should refrain from participating in discussions and from voting on any resolution on the issue in respect of which the conflict of interest has arisen,
- 2) Management board members should inform the supervisory board whenever a conflict of interests arises, or if there is a risk of a conflict of interests arising in connection with the function performed.

Furthermore, pursuant to the KDPW S.A.'s Articles of Association, members of the Management Board of KDPW S.A. may be members of the governing bodies of other companies only with the express permission of the Supervisory Board of KDPW S.A. Whenever any conflict between KDPW S.A. and its participants or among these participants occurs, it is resolved by the Court of Arbitration at KDPW S.A. according to the provisions of the KDPW S.A.'s Articles of Association.

### **Disclosure of the governance arrangements and the objectives of the KDPW S.A.**

The Statute and the following information are publicly available on the KDPW S.A. website:

- (1) description of the kdpw\_stream and its regulations regarding its operation as a clearing house and SSS: KDPW Rules, the Detailed Rules of Operation of KDPW, the



- Registration Procedures, the Rules of Settlement Guarantee Fund, The Rules Of Operation Of The Compensation Scheme, etc.
- (2) the structure of ownership and the composition of the Management Board and the Supervisory Board.

The abstract of the Strategy for 2010-2013 has been published on the website and presented publicly.

### **Limits on credit exposure to participants**

There is a clear separation between the reporting lines to the Management Board for credit risk management subjects and those for other operations. In KDPW S.A., there is a Risk Committee responsible for the actions to be taken in the case of a clearing member's insolvency or when there is a danger that such an event may happen.

According to the Polish law, there is no obligation to set the limits of total credit exposure to participants and large individual credit exposures. Further to that, the Management Board does not approve any limits of total credit exposure to participants and large individual credit exposures. Any risks stemming from transactions concluded by kdpw\_stream clearing members on the organised cash and derivatives markets are covered by the Transaction Settlement Liquidity Guarantee System which, as described earlier, encompasses:

- 1) operating guarantee funds,
- 2) acting as an intermediary in both: the arranged and the automated securities lending by offering a centralised facility,
- 3) lending/borrowing transactions on a bilateral basis between participants (without intermediation of KDPW S.A.),
- 4) using of the capital of guarantor which is a separate legal entity owned by KDPW S.A.

As regards the securities lending and borrowing, it has to be pointed out that KDPW S.A. does not act as a principal and all positions are fully collateralised.

Pursuant to the paragraph 66 of the KDPW Rules, the Management Board may only define, by way of resolution, an engagement limit which relates to the total value, or the number of open positions in derivatives of a given series, or in derivatives of all series based on the same underlying instrument, for which that participant holds the status of a clearing member.

#### **RECOMMENDATION 14: ACCESS**

*CSDs should have objective and publicly disclosed criteria for participation that permit fair and open access. Rules and requirements that restrict access should be aimed at controlling risk.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 14 is observed.

#### **Access criteria in KDPW S.A.**

Pursuant to the article 52 of the Act on Trading in Financial Instruments, an entity which has obtained the Polish Financial Supervision Authority's authorisation for keeping securities accounts or which keeps such accounts pursuant to article 117 and meets the requirements provided for in the KDPW Rules, is entitled to demand conclusion of a participation agreement.

According to the given above, the other criteria of participation are specified in the KDPW Rules. These criteria include obligation to meet by direct participants the appropriate material and technical requirements. Meeting the appropriate material and technical requirements shall mean the participant maintaining technical and technological equipment, which ensures the participant is able to connect with the IT system of the KDPW S.A. (kdpw\_stream) used to manage the depository-settlement system, ensuring that documents can be safely sent to and received from that system in electronic form. It also means that participants managing securities accounts maintain technical and technological equipment, which ensures at minimum that entries may be made in securities accounts, that information on the entries made on these accounts may be processed and archived, and that the contents of documents, on the basis of which the entries were made, may be reproduced, while meeting the appropriate requirements arising from the provisions of the Act on Trading in Financial Instruments, as well as executive instruments derived from this legislation, and arising from the rules and resolutions of the Management Board of KDPW S.A. issued on the basis of the legislation.

According to the Act on Trading in Financial Instruments, the Management Board of KDPW S.A. may pass a resolution (in writing) to refuse conclusion of a participation agreement within two weeks after submission of request to conclude the agreement. The applicant has the right to appeal to the Supervisory Board of KDPW S.A. against such a resolution. The Supervisory Board shall consider the appeal within two weeks from the date of its submission.



The KDPW Rules, which, as described, include criteria of participation, are accessible on the KDPW S.A. website. They are also subject to approval by the Polish Financial Supervision Authority.

### **Access limitations**

The KDPW Rules, containing participation requirements, are defined in a way to ensure equal treatment for all direct participants, regardless of their identity, type and location. According to the Rules, foreign institutions may also become direct kdpw\_stream participants. They are subject to the same material and technical requirements as Polish participants.

As regards the fee structure, there is no differentiation of conditions in terms of type of activity and location of a given entity.

### **Procedures facilitating the orderly exit of participants**

Conditions pertaining to termination and suspension of participation in the kdpw\_stream are specified in the KDPW Rules. KDPW S.A. may terminate a participation agreement with immediate effect (cancellation of participation) or refrain from carrying out the agreement (suspension of participation) if a participant threatens the safety of trading or the proper operation of the depository-settlement system. Such a threat occurs, specifically, if a participant contravenes the legal provisions regulating the operation of the depository-settlement system or provisions of the KDPW Rules. Participation may be suspended or cancelled with regard to all of the participant's activities under the participation agreement or with regard to only some activities.

In order to facilitate the exit of members which no longer meet the participation criteria or restore the participation, if it was suspended, KDPW S.A. takes the measures described herein. The decision to suspend participation shall specify conditions needing to be met in order for the previous participant status to be restored. Suspension and cancellation of participation shall not affect the participant's obligations arising from its activities carried out up to the date of suspension or cancellation. While participation is suspended or after it has been terminated only those operations, which may be validated by events that took place before the suspension or termination date, are carried out on the accounts kept in kdpw\_stream for the participant concerned. An institution or body keeping securities accounts, whose participation has been terminated, is obliged to take measures in order to transfer securities registered in those accounts to another participant. The KDPW S.A. has the right to sell securities owned by that institution or body acting on its account, if those securities have not been transferred to another participant within one month of the termination of participation. If participation of an indirect participant is terminated, the participant's agent is obliged to carry out this sale of securities.

According to the article 89 of the Act on Financial Trading in Financial Instruments, the brokerage licence granted by the Polish Financial Supervision Authority expires:

- 1) if the investment firm fails to commence brokerage activities by the date specified in the decision granting the licence,
- 2) upon declaration of the investment firm's bankruptcy,
- 3) if liquidation proceedings are opened with respect to the investment firm – following three months from the proceedings opening date.

In the event of expiry or revocation of the licence, or discontinuation of the keeping of securities accounts, by an entity conducting brokerage activities, the Polish Financial Supervision Authority may order a transfer of financial instruments and any cash and documents related to the keeping of securities accounts to another investment firm, subject to such firm's prior consent. In all other cases, the handling of the documents related to the conduct of brokerage activities is regulated by the provisions of the Commercial Companies Code of September 15th 2000.

### **Additional information**

It should be noted that Polish law does not support the concept of omnibus accounts. Existing two-tier holding structure in Poland envisages that the accounts segregation is done on the level of the direct kdpw\_stream participants. The introduction of the concept of omnibus accounts to the Polish law is in progress.

#### **RECOMMENDATION 15: EFFICIENCY**

*While maintaining safe and secure operations, securities settlement systems should be cost-effective in meeting the requirements of users.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 15 is observed.

#### **Review of costs and pricing**

The model of controlling which has been implemented in KDPW S.A. enables a regular comparison of pricing levels and operating costs of performed processes with other CSDs, as required by the European Code of Conduct for Clearing and Settlement.

Calculation of costs of processes is performed in accordance with the ABC (Activity Based Costing) methodology adopted for the purpose of the controlling model (the methodology is applied for allocating revenues and costs to the services which are covered by the Code of Conduct). The said calculation is performed monthly, in the my-SAP ERP system management accounting module.

A specific comparative (bottom-up) analyses of fee rates in kdpw\_stream and in other European depository and clearing institutions are performed every year. The results of the analyses are provided to the Management Board and are taken into account in case of fees modifications.

#### **Review of service levels and operational reliability**

KDPW S.A. regularly reviews its operational reliability (including adequate capacity) and service levels, including regularly surveys of its users.

The service levels of kdpw\_stream have been described in the Detailed Rules of Operations and Information Exchange System Agreement. In line with the agreement KDPW IT help-desk is available at the same time when settlement system is opened for communication with participants. The main tasks of the IT help desk is to monitor the performance and reliability of the settlement system, register problems related to functioning of the system, allocate dedicated resources in order to remove the existing deficiencies. The IT systems are maintained and developed internally in line with the existing procedures based on best practices for the industry and done on the basis of internal procedures in cooperation with participants. KDPW S.A. also signed SLA agreements with IT providers, which allow maintenance and scalability of computer hardware and telecommunication channels.

Some areas of the service levels and quality, which have direct impact on discontinuity of internal processes, are regularly reviewed once every 4 months by the Operational Risk Committee in the presence of a member of the Management Board. The operational reliability of IT systems is reviewed twice a year during performance of Business Continuity tests one of which is carried out with attendance of market participants. As an outcome of the tests there are made modifications and adjustments of IT systems for stability and reliability purposes.

Besides the daily monitoring of the IT systems, the capacity of the systems is tested irregularly, however in the opinion of the assessors, the frequency of tests is sufficient. The standard daily operations use only about 5-10% of maximal settled volumes of transactions. The only stressful conditions for the system occur very occasionally during large mass privatisation IPO's that are processed in parallel to the daily clearing and settlement of transactions concluded on the secondary market.

KDPW S.A. has also implemented internal procedures and IT tools that allow monitoring of the efficiency and capacity of the IT systems, i.e. system occupancy, usage of processors, disc and memory resources, response times of journaling subsystems. Efficiency analyses of key processes are measured and assessed at that time.

## **RECOMMENDATION 16: COMMUNICATION PROCEDURES, MESSAGING STANDARDS AND STRAIGHT-THROUGH PROCESSING (STP)**

*CSDs and participants in their systems, should use or accommodate the relevant international communication procedures and standards for messaging and reference data in order to facilitate efficient clearing and settlement across systems. This will promote straight-through processing (STP) across the entire securities transaction flow.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 16 is observed.

### **Application of international communication procedures and standards**

KDPW S.A. applies international communication procedures and standards in the kdpw\_stream clearing and settlement system.

The standard SWIFT ISO15022 messaging channel is currently offered to kdpw\_stream participants for both the cross-border transfer of securities, as well as the domestic clearing and settlement processing. An alternative real-time proprietary communication channel, based on xml technology as well as a secure and highly resilient network solution, ensure the high level of STP processing.

In all of the communication channels a broad range of international standards is being used, including: ISIN codes for securities identification (ISO 6166), BIC codes (optionally) for counterparty identification (ISO 9362), currency codes (ISO 4217), market identifier codes (ISO 10383) and country codes (ISO 3166).

For the new functionalities and developments, KDPW IT strategy recommends using ISO20022 messages wherever it proves feasible.

To ensure the effective implementation of new recommendations in the dynamic situation of regulations in Europe, KDPW S.A. and KDPW\_CCP S.A. actively participate in international standards and industry organizations e.g. ECSDA, EACH, CCP12, ISSA, ANNA and SMPG among the others.

### **Implementation of STP and interoperability between systems**

The kdpw\_stream clearing and settlement system, operating since 2009, provides high level of STP across all the business processes being offered by using propriety communication channels based on xml technology. Additionally, in 2010 KDPW S.A. opened a new SWIFT based communication channel for clearing and settlement that offers interoperability between the systems.

When moving from one system to another, some adaptation work cannot be excluded in case when participants use solutions based on market practices different than the one used in kdpw\_stream.

All new solutions introduced in kdpw\_stream will apply the ISO20022 standard for messaging, for the business areas covered by this standard, in order to ensure the highest available level of interoperability and standardisation for the kdpw\_stream participants.

## RECOMMENDATION 17: TRANSPARENCY

*CSDs should provide market participants with sufficient information for them to identify and accurately evaluate the risks and costs associated with securities clearing and settlement services.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 17 is observed.

### Public disclosures

KDPW S.A. makes clear disclosures to market participants about system's rules, regulations, relevant laws, governance procedures, its services offered, any risks, risks arising either to participants or to the operator, any steps taken to mitigate those risks, its balance sheet data, main statistics and prices/fees associated with securities clearing and settlement services. These disclosures also include the risk exposure policy and risk management methodology.

The above mentioned information is available on the KDPW S.A. website ([www.kdpw.pl](http://www.kdpw.pl)). The website includes a special section devoted to the KDPW system ([kdpw\\_stream](http://www.kdpw.pl/pl/serwisy/Strony/default.aspx)) and to the risk management system based on the SPAN methodology (<http://www.kdpw.pl/pl/serwisy/Strony/default.aspx>). There is also disclosed the questionnaire set out in the CPSS/IOSCO Disclosure Framework on the KDPW S.A. website ([http://www.kdpw.pl/pl/harmonizacja/praceharmonizacyjne/Documents/D\\_framework\\_2007.pdf](http://www.kdpw.pl/pl/harmonizacja/praceharmonizacyjne/Documents/D_framework_2007.pdf))

The website is available in Polish, English and Russian language version. The most significant documents are published in Polish and English language in PDF or DOC format or directly.

KDPW S.A. had expressed its intention to publish the assessment's results on its website, together with its regular reviews. It is intended to pass the updates of regular assessments to the regulators for appropriate relevant approval. Also, it is NBP's KNF's intention to pursue the reviews of the assessment of the [kdpw\\_stream](http://www.kdpw.pl) system against ESCB-CESR Recommendations or other recognized recommendations and standards on an regular basis.

## **RECOMMENDATION 18: REGULATION, SUPERVISION AND OVERSIGHT**

*CSDs and securities settlement systems should be subject to transparent, consistent and effective regulation, supervision and oversight. In both a national and a cross-border context, central banks and securities regulators should cooperate with each other and with other relevant authorities regarding the CSD and the securities settlement systems it operates. Central banks and securities regulators should also ensure a consistent implementation of the recommendations.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 18 is observed.

The Polish legal system, and similarly the Polish language, do not differentiate the concepts of supervision and oversight. For the purpose of this assessment, NBP and Polish FSA consider supervision to be a function performed by public authorities in order to assess and enforce the compliance by KDPW S.A. with laws, regulations or other rules intended to ensure that it operates in a safe and sound manner, whereas oversight is defined as activity whereby the objectives of safety and efficiency are promoted by monitoring kdpw\_stream system, assessing it against the applicable standards and principles and, where necessary, fostering change.

Pursuant to the article 2 of the Act on Financial Market Supervision of 21 July 2006, the purpose of the Polish FSA's supervision over the financial market is to ensure proper operation, stability, security and transparency of the financial market, as well as confidence in that market, and to safeguard the interests of the financial market participants through the pursuit of objectives stated in inter alia the Act on Capital Market Supervision of 29 July 2005. According to the article 4 of the Act on Capital Market Supervision, the objective of the supervision is to ensure proper operation of the capital market and, in particular, security of trading and protection of investors and other market participants, as well as compliance with the principles of fair trading. Pursuant to this Act, the Polish FSA's supervision is cover entities which conduct activities on the capital market on the basis of authorisations issued by the Polish FSA (or another competent administrative authority), inter alia company maintaining a depository of securities as defined in the Act on Trading in Financial Instruments – KDPW S.A.

### **Regulation, supervision and oversight of KDPW S.A.**

KDPW S.A. is subjected to supervision and oversight of the Polish Financial Supervision Authority. National Bank of Poland supports Polish FSA in performing oversight tasks. Supervision and oversight over KDPW S.A. are transparent, consistent and effective. Supervision and oversight activities are regulated by the Act of 29 July 2005 on Trading in Financial



Instruments, Act of July 21st 2006 on Financial Market Supervision, Act on Capital Market Supervision dated July 29th 2005 (Polish and English versions of these Acts are available on Polish FSA website – [www.knf.gov.pl](http://www.knf.gov.pl)).

Pursuant to the above mentioned Acts, the Polish FSA is entitled to impose the following supervisory tools:

- the right to enter the registered office of KDPW S.A. in order to inspect the books, documents and information stored in other forms;
- competence to request KDPW S.A. to promptly prepare and deliver, at the cost of the company, the copies of documents and other data carriers and to provide necessary written or oral explanations;
- right to participate in meetings of the supervisory board of the KDPW S.A. and in general shareholders meetings;
- competence to raise objections to any intended direct or indirect acquisition of or subscription for a specified number of shares of KDPW S.A.,
- competence to request assembling the extraordinary general shareholders meeting, or include the matters indicated by Polish FSA in the agenda of the general shareholders meeting;
- competence to order the supervisory board of KDPW S.A. to promptly, and in any case no later than within ten business days, adopt a resolution on a specific matter;
- the right to appeal to court against the resolution of the general shareholders meeting or the supervisory board within 30 days of becoming aware of such a resolution if it was adopted in contradiction or violation of law, the articles of association, the rules or the principles of secure trading;
- competence to supervise the financial statements or other financial information of KDPW S.A.

As mentioned above, the Polish FSA performs oversight over kdpw\_stream – securities settlement system operated by the KDPW S.A. National Bank of Poland supports Polish FSA in performing this task. At the request of President of NBP, the members of KDPW S.A. management board or persons employed by KDPW S.A. are obliged to provide written information on the matters concerning the functions of KDPW S.A. related to clearing and settlement of transactions in financial instruments. Furthermore, in case when, in the opinion of NBP, the activities of KDPW S.A. related to carrying out the clearing or settlement of transactions in financial instruments does not ensure the safe and efficient functioning of settlement systems operated by KDPW S.A., the NBP shall notify Polish FSA. One of the main oversight tool used by Polish FSA is the competence to approve internal KDPW S.A. regulations related to the performance of kdpw\_stream, i.e. KDPW Rules. This act is approved by Polish FSA after obligatory consultation with the President of the National Bank of Poland. The other oversight tools used by the NBP are:

- Part-ownership competence:

National Bank of Poland owns 33% of KDPW S.A. shares. This allows NBP to influence kdpw\_stream's performance via participation of NBP's representatives in KDPW S.A.'s corporate bodies.

- Contractual influence:

NBP acts as a kdpw\_stream's user and as a provider of services, KDPW participates in RTGS system operated by NBP.

- Moral Suasion.

### **Disclosure of responsibilities, roles and major policies of Polish FSA and NBP**

The responsibilities, role and key aspects of the major policies of the Polish FSA are clearly defined by the relevant acts of law and published on the Polish FSA's website: [www.knf.gov.pl](http://www.knf.gov.pl) (also in English version).

Annually Reports on Activities of the Polish Financial Supervision Authority are published on the Polish FSA's website since 2007. The above mentioned document provides information on financial market in Poland, supervisory activities, protection of retail clients, educational and informational initiatives concerning the financial market, measures taken to counteract market abuse and international cooperation of the Polish FSA. The reports comprise detailed information on the Polish FSA's supervision over the entities acting on the Polish capital market (including KDPW S.A.).

The responsibilities, role and key aspects of the major policies of National Bank of Poland are defined by relevant acts of law and disclosed on NBP's public webpage ([www.nbp.pl](http://www.nbp.pl)). Also, the role of the National Bank of Poland is described in the *Securities Settlement Systems in Poland and the EU* – publication available on NBP's webpage. Moreover, NBP periodically publishes studies and reports which cover the performance of payments and financial system (The Financial Stability Reports, the Assessment of Payments System Performance).

### **National and cross-border cooperation of Polish FSA and NBP**

The Polish FSA and NBP cooperate in carrying out their respective duties arising from their statutory responsibilities related the supervision of KDPW S.A. and the system operated by the company. The principles of cooperation between two institutions are defined in the *Memorandum of Understanding on exchanging information, including opinions between NBP and Polish FSA* which was signed on 14<sup>th</sup> of December 2007.

Pursuant to the Act on Trading in Financial Instruments, the Polish FSA and NBP cooperates with each other in the process of approving the Rules of the National Depository for Securities. and its amendments. This act, which regulates clearing and settlement functions of KDPW S.A. is subjected to the Polish FSA's approval, issued after obligatory consultation with the President of the NBP. Moreover, NBP notifies Polish FSA of any event when the settlement of the securities carried out by KDPW S.A., does not provide secure and efficient operation of the SSS.

Furthermore, in accordance with the Act on Settlement Finality in Payment and Securities Settlement Systems and the Rules of Oversight of these Systems, the establishment of a new SSS

or the change of its functioning principles, that requires the consent of the Polish FSA, is issued after consultation with the President of the NBP.

As a part of its supervision and oversight competences, NBP and Polish FSA intend to perform thorough assessment of Polish post-trade market infrastructure against recognized recommendations annually.

### **Information necessary for regulation, supervision and oversight**

Crucial operational, policy or business decision made by KDPW S.A. which could be significant from supervision or oversight perspective are discussed by the supervisory board of the company. Since the authorised representative of Polish FSA has a right to participate in meetings of the supervisory board and the representatives of the NBP are members of the supervisory board, the information about these decisions is provided to supervisors and overseers in advance. Moreover Polish FSA has the competence to request KDPW S.A. to deliver any information about its performance at the cost of the company.

According to the Act on Trading in Financial Instruments, crucial operations can be outsourced by KDPW S.A. only by a written agreement. KDPW S.A. is obliged to immediately notify the Polish FSA of such agreement, indicating the entity to which it has delegated the performance of its activities, their scope and any information of an amendment or the termination of such agreement.

### **International cooperation of supervisors and overseers**

Polish FSA cooperates with European Securities and Markets Authority (ESMA). The Polish FSA's representative participates in the works of the Post-Trading Standing Committee - expert group of ESMA. Polish FSA concluded agreements on cooperation and exchange of information (i.e. Memoranda of Understanding) with 50 entities from all over the world.

National Bank of Poland, as a part of European System of Central Banks (ESCB), composed of the European Central Bank and the national central banks of all 27 European Union Member States, actively cooperates within ESCB framework, including the Working Group on Oversight and Payment and Settlement Systems Committee. Similarly as Polish FSA, National Bank of Poland participates in the works of ESCB-CESR Working Group.

## **RECOMMENDATION 19: RISKS IN CROSS-SYSTEM LINKS OR INTEROPERABLE SYSTEMS**

*CSDs that establish links to settle cross-system trades should design and operate such links so that they effectively reduce the risks associated with cross-system settlements. They should evaluate and mitigate the potential sources of risks that can arise from the linked CSDs and from the link itself.*

NBP and Polish FSA's assessment of observance:

In the view of the National Bank of Poland and Polish Financial Supervision Authority, Recommendation 19 is observed.

### **Risks associated with cross-system settlements**

KDPW S.A. operates only free of payment links all of which are used for the purpose of securities transfer to enable dual listing of those securities. KDPW S.A. also established relayed links through 2 ICSDs – Euroclear Bank and Clearstream Banking Luxembourg. For all these links KDPW S.A. has implemented reconciliation procedures.

KDPW S.A. performs analyses of links to eliminate any legal, contractual, financial and operational risks. These analyses are carried out prior to the start of the building process and updated after any substantial change. KDPW S.A. provides participants with guides to all markets with which it established links. These guides include description of the relevant market, including applicable laws and rules for processing operations in that market and any associated risks. They are accessible on the KDPW S.A. website.

In terms of efficiency of relayed links operated by KDPW S.A. there are some effects arising from the fact that there is one additional entity in the chain. Securities transfers between markets may take longer to process, however any potential delay is minimised by using real-time settlement mode. There are some implications for processing corporate events. When sending information about Polish-based holders of rights in securities (beneficial owners) to the issuer CSD via the relayed link, i.e. ICSD, the deadline for kdpw\_stream participants is of course much shorter than it would be if a direct link were in place. To mitigate any potential risks stemming from the given issue, KDPW S.A. provides participants with necessary information in order to make them aware well in advance of events that require a response before a deadline. In terms of costs the only negative effect of using relayed links by KDPW S.A. is the need to cover additional fee relating to the involvement of additional intermediary in the chain.

### **Credit extensions and liquidity risks**

All securities transfers through links operated by KDPW S.A. are free of payment and done on real-time gross settlement basis so that there are no credit extensions available. All foreign securities, which are dual-listed on the Warsaw Stock Exchange (WSE), are settled in Polish Zloty. Therefore, KDPW S.A. established the same liquidity management tools for foreign and domestic securities within the Transaction Settlement Liquidity Guarantee System. The links are used to transfer securities between markets prior to trading on the WSE so the securities are already present in the securities account of the investor, thus eliminating settlement risk.