
KDPW_CCP ... Is Only the Beginning

PRESS RELEASE

The National Depository has transferred to KDPW_CCP all functions related to the clearing of transactions executed on the regulated market and in the alternative trading system and the operation of the clearing guarantee system as of 1 July 2011. KDPW remains responsible for transaction settlement and central securities depository functions. The process implements world-class standards at KDPW and enhances the competitiveness of the Polish capital market. The spin-off of the clearing house from KDPW's structure derives from the National Depository Strategy 2010-2013 adopted in late 2009 and consistently pursued among others to develop a new business model of KDPW.

The establishment of KDPW_CCP is one of the key projects under the KDPW Strategy 2010-2013 aiming to ensure greater competitiveness and growth of the entire capital market. The project is one of several dozen initiatives taken by the National Depository in order to strengthen the position and the quality of services available in Poland, which aspires to become the regional financial hub of Central and Eastern Europe.

The KDPW Strategy provides for a number of projects supporting the growth of the Polish capital market and generating benefits to Polish retail and institutional investors and foreign investors. These projects will reduce the cost of clearing and settlement and consequently also the cost to investors.

The division of clearing and depository functions between two separate entities, KDPW_CCP and KDPW, is consistent with international standards and recommendations. It will ensure harmonious development of services offered by both companies to meet clients' needs, address market challenges and face international competition.

The following projects are crucial to further development of KDPW_CCP:

- ❖ **Securities netting**
- ❖ **OTC Derivative CCP**
- ❖ **Development of services offered by GIR KDPW**
- ❖ **Securities lending platform**
- ❖ **Hold-Release mechanism**

Securities netting

Securities netting will enable KDPW_CCP to generate single settlement instructions (covering both securities and cash settlement) for KDPW (as a clearing house and central securities depository) for all operations cleared by CCP within a clearing session for a given registration account in order to credit or debit a given registration account operated by KDPW.

The implementation of this project will introduce European standards to the Polish market and strengthen the competitiveness of clearing and settlement services offered by KDPW_CCP and KDPW, which may improve customer retention and acquisition of new foreign clients.

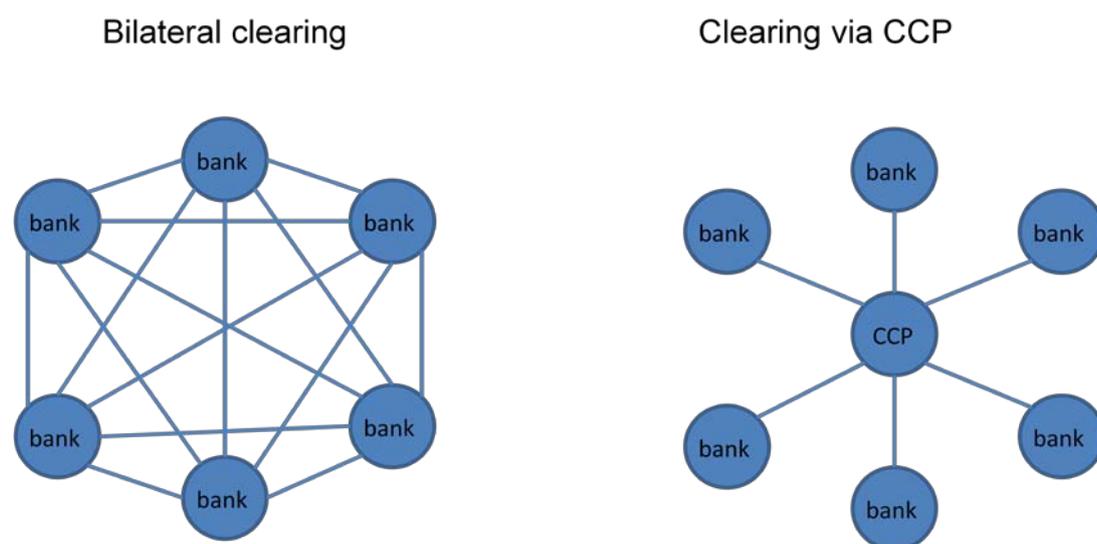
In view of the planned co-operation with Target2Securities, the introduction of netting will reduce the number of operations included in calculations of settlements to be processed by T2S.

OTC Derivative CCP

The project of clearing and guaranteeing OTC derivative transactions aims to improve the safety of clearing transactions executed outside the organised market.

KDPW is developing solutions which will address the needs and expectations of market participants as well as proposed European Commission regulations concerning clearing of OTC derivative transactions by CCPs and the operation of CCPs. Under these regulations, by the end of 2012, all transactions of EU banks in derivative instruments specified by the market regulator will have to be cleared by CCPs. The proposed regulations also require OTC trade reporting to central trade repositories. The National Depository is aiming to support these functionalities which are complementary to the planned clearing functions.

Fig. 1. Improved organisation of OTC markets owing to CCP clearing



Source: KDPW study

KDPW is the only institution on the Polish capital market which has the necessary organisational and technological infrastructure ensuring the safety of clearing, expertise and experience, and a system of communication with banks. In addition, KDPW is planning to join the real-time gross euro settlement system TARGET2 and to initiate discussions with NBP in order to join the currency settlement system CLS (Continuous Linked Settlement).

The range of instruments cleared by KDPW_CCP is designed with a view to gradual addition of OTC derivative instruments in order to eventually cover all instruments in the portfolios of banks operating in Poland. In the first phase of the project, the list of instruments includes derivatives settled in PLN on a net basis.

The list of instruments cleared in phase 1 includes:

- ❖ forward rate agreements (FRA);
- ❖ interest rate swaps (IRS, OIS, basis swap);
- ❖ repo.

In the second phase of the project, the following may be added to the list of instruments cleared by KDPW_CCP:

- ❖ FX swaps;
- ❖ FX options;
- ❖ interest rate options;
- ❖ currency interest rate swaps (CIRS).

From the very beginning, all OTC transactions cleared by KDPW_CCP will be covered by a three-tier clearing guarantee system according to planned regulations and international standards.

Fig. 2. KDPW_CCP's Multi-tier clearing guarantee system



Source: KDPW study

According to the timetable agreed with market participants (banks), the OTC CCP will go live in June 2012. KDPW plans to make the service fully functional by the effective date of European OTC clearing regulations.

Development of services offered by GIR KDPW

POEE WSE Energy Market opened on 11 December 2010. As of that date, the Exchange Clearing House of the National Depository for Securities (GIR KDPW) guarantees and clears orders and trades on that market. The establishment of the Exchange Clearing House is a part of the Strategy 2010-2013, whereby KDPW extends the range of its services and enters new business segments.

Fig. 1. WSE Energy Market trading and clearing organisation



Source: KDPW study

Thanks to many years of experience on the Polish capital market, the National Depository offers prompt clearing and settlement of transactions on the WSE Energy Market based on state-of-the-art technologies.

The transfer of the functions of GIR KDPW to KDPW_CCP will ensure new solutions, even more beneficial to GIR members.

The transfer of settlements from a commercial bank (used now) to the central bank will improve the safety of settlements. Clearing House members will be able to use their clearing accounts in any bank in Poland, thus becoming independent of the single clearing bank.

Once the services offered by KDPW GIR are taken over by the clearing house, the safety of the clearing guarantee system in the segment will also improve. The current POEE WSE Energy Market Transaction Clearing Guarantee System comprised of margins and a clearing fund will be complemented with another guarantee component: the capital of the KDPW_CCP clearing house.

New clearing house functionalities and new solutions will be developed and implemented in co-operation with GIR members. GIR will also co-operate with the WSE to introduce new instruments to the market and to offer clearing for new markets.

Securities lending platform

An electronic securities lending platform is currently under development in order to bring together offers of lenders and borrowers. KDPW has more than 10 years of experience in operating a securities lending system securing the liquidity of clearing. This experience will be leveraged in order to further develop the securities lending market.

The goal of the project is to offer an effective securities lending tool to the participants of the Polish capital market. This will be accompanied by new services offered by KDPW, which will

organise (in co-operation with the WSE) securities lending initiated by market participants and institutional investors.

The project is particularly relevant to the development of short selling on the Polish market. Short selling requires the possibility of borrowing securities on the market for the investor to sell them at a certain time and later to buy them back at a much lower price and return them to the lender. Brokerage houses and banks whose clients want to use short selling to offer securities will be able to borrow securities on the market from other brokerage houses or banks quickly and effectively.

While the solution is addressed directly to KDPW members, it will provide tangible benefits to investors as the main beneficiaries of the service.

Securities lending has an important impact on the growth of the market as a whole by:

- ❖ increasing market liquidity (securities held in long-term portfolios of institutional investors return to the market in short sale transactions and increase the number of free float securities);
- ❖ increasing the liquidity of clearing (mainly short sale transactions);
- ❖ improving the effectiveness of valuation of securities on the cash and the derivative market;
- ❖ providing new investment strategies which enable important market operations, e.g., arbitration, delta hedge.

Hold-Release mechanism

The Hold-Release mechanism is a technical instrument enabling prompt matching of settlement instructions, the use of single instructions for matching and final settlement, and separation of the instructions matching process from the verification of availability of cash and securities necessary for settlement.

The Hold-Release mechanism operates by assigning the following status to matched instructions:

- ❖ **Hold** – to hold the settlement of a transaction concerned by the instructions; in particular, to hold the settlement of such transactions for which it is not certain whether there is coverage in securities or cash;
- ❖ **Release** – to release the settlement of a transaction; a transaction under instructions with Release status will be settled without additional actions of the participant.

Hold and Release status is assigned unilaterally, and the change of status does not require consent of the counterparty.

The Hold-Release mechanism will be used in implementation of settlement instructions matching standards under the ESSF/ECSDA document “Proposals to harmonise and standardise pre-settlement date matching processes throughout Europe.”

The implementation of the project will reduce the number of not cleared instructions and consequently reduce the cost of settlement.
