

GOVERNING LAW AND DESCRIPTION OF MAIN LEGAL CONSEQUENCES OF BANKRUPTCY OF A CLEARING SYSTEM PARTICIPANT AND ASSET SEGREGATION

Pursuant to Article 5 of the Act of 24 August 2001 on Settlement Finality in Payment and Securities Settlement Systems and the Rules of Oversight of these Systems ("Settlement Finality Act"), legal consequences arising from a declaration of bankruptcy or a foreign bankruptcy proceedings being opened against an entity that is domiciled in the Republic of Poland and participates in a payment system or a securities settlement system governed by the laws of another Member State concerning the rights and obligations of the entity related to its participation in the system shall be determined by the law governing that system. The law governing the transaction clearing system organised by KDPW_CCP is Polish law.

Bankruptcy issues are governed by the Act of 28 February 2003 on Bankruptcy Law ("Bankruptcy Law"). The transaction clearing system organised by KDPW_CCP is considered to be a system within the meaning of Article 1.1 of the Settlement Finality Act. Pursuant to Article 11 of the Settlement Finality Act, in the event that a participant in the system is declared bankrupt, its rights and obligations related to the participation in the system shall be governed by Polish law.

Pursuant to Article 66.1 of the Bankruptcy Law, the bankruptcy estate of a participant in a payment system or a securities settlement system shall not include the assets of the bankrupt listed in Article 80 of the Bankruptcy Law as well as other assets necessary to perform obligations resulting from the participation in the system, which arose prior to the declaration of bankruptcy. In order to perform the obligations, the operator of the system shall be empowered to dispose of such assets.

Pursuant to Article 80 of the Bankruptcy Law, referred to above, the declaration of bankruptcy of a participant in a payment system or a securities settlement system shall not prevent the use of:

- 1) funds and financial instruments within the meaning of the Act of 29 July 2005 on Trading in Financial Instruments ("Act on Trading in Financial Instruments"), deposited and recorded on the participant's clearing account, which are not encumbered with a right *in rem* in favour of a third party,
- 2) financial instruments recorded on the bankrupt's clearing account as a collateral security for a bank credit extended with the payment system or securities settlement system if such credit may be disbursed under an existing loan agreement – for the purpose of performing the bankrupt's obligations that arise from settlement orders entered into the system at the latest on the system business day starting on the date bankruptcy is declared (system business day is understood as an order execution cycle, defined in the operating rules of the payment system or securities settlement system, during which clearing and settlement are processed and other related operations are performed, where such a day may start and end on subsequent calendar days).

Pursuant to Article 67 of the Bankruptcy Law, the collateral security established in connection with the participation in a payment system or a securities settlement system provided to the operator of the system or a participant in the system shall not be included in the bankruptcy estate of:

- 1) the participant in the system or the participant of a system which has interoperability arrangements with it, which has provided the collateral,

- 2) the entity operating the system which has interoperability arrangements with it, not being a participant,
 - 3) any other entity which has provided the collateral
- in the case of a declaration of bankruptcy of any of them.

Pursuant to Article 6a of the Settlement Finality Act, legal consequences connected with the protection of the execution of orders under bankruptcy law arise as of the date of entering an order into the clearing system if the order is settled in another system as a result of clearing. The consequences set out in Articles 136 and 137 of the Bankruptcy Law resulting from a settlement order being entered into the former system apply respectively to settlement orders resulting from it and executed in the latter system if the order is settled in the latter system as a result of clearing of the settlement order in the former system. Pursuant to Articles 136 and 137 of the Bankruptcy Law, if a participant in a payment system or a securities settlement system is declared bankrupt, the legal consequences of a settlement order resulting from it being entered into the system and the results of netting shall be legally enforceable and binding on third parties if the order was entered into the system prior to the declaration of bankruptcy. If the settlement order has been entered into the system after the declaration of bankruptcy and is carried out on the system business day starting on the date bankruptcy is declared, the legal consequences resulting from it being entered into the system shall be legally enforceable and binding on third parties only if the operator of the system proves that it was not aware, nor should have been aware, of the declaration of bankruptcy at the time the order became legally enforceable according to the operating rules of the system.

Pursuant to Article 45e of the Act on Trading in Financial Instruments, initiating bankruptcy, recovery, enforcement or liquidation proceedings as well as taking other legal measures against a participant or other entity making transactions:

- 1) on a regulated market,
 - 2) in an alternative trading system,
 - 3) on OTF,
 - 4) outside a financial instruments trading system – if they are cleared by a clearing entity
- which result in the suspension or termination of its making debt payments, or
 - which result in the limitation of its capability to freely dispose of its property, including the suspension of a bank's activities under the procedures specified in the Act of 29 August 1997 on Banking Law, shall not produce legal consequences concerning the funds in a deposit account, omnibus account, securities account, derivatives account, cash account or bank account of the participant or other entity which is used to clear transactions to the extent in which the funds are needed to carry out the settlement of transactions in the settlement entity, even if such proceedings or liquidation were initiated or even if other legal measures were taken before carrying out the settlement of the transaction. The legal measures referred to above do not have legal consequences with respect to an entity being the beneficial owner of a collateral security for a collateral established by a participant or other entity making transactions:
- 1) on a regulated market,
 - 2) in an alternative trading system,
 - 3) on OTF,
 - 4) outside a financial instruments trading system – if they are cleared by a clearing entity
- provided to another participant or the clearing entity, on the terms set out in the rules of the clearing entity.

Pursuant to Article 45e (2a-2d) of the Act on Trading in Financial Instruments, the aforementioned legal measures:

1) do not terminate any proxy granted to the entity operating a settlement system or to a participant of that entity or any proxy granted by a participant of the entity against which those measures are applied, authorising the submission of settlement orders on behalf of that participant,

2) do not affect the rights of the clearing entity as set out in the rules of the clearing entity to:

a) terminate the agreement concerning participation in the clearing entity together with the agreements to which that entity has become a party as a result of the clearing novation of transactions accepted for clearing under the agreement concerning participation in the clearing entity,

b) refrain from performing the agreement concerning participation in the clearing entity,

3) do not affect the rights of the clearing entity to net or offset debits arising from:

a) the clearing of transactions referred to in Article 45e (1) of the Act on Trading in Financial Instruments,

b) collateral established for the benefit of the clearing entity or other participant,

c) participation in the system guaranteeing the performance of obligations arising from transactions referred to in Article 45e (1) of the Act on Trading in Financial Instruments

- on the terms set out in the rules of the clearing entity,

4) do not affect the rights of:

a) the clearing entity, and

b) the participant

- arising from a clause in the agreement concerning participation in the clearing entity which sets out the terms of clearing of the parties in respect of the termination of the agreement concerning participation in the clearing entity and the agreements to which the clearing entity has become a party as a result of the clearing novation of transactions accepted for clearing under the agreement concerning participation in the clearing entity in connection with the application of the aforementioned legal measures against the clearing entity or its participant.

Pursuant to Article 70 of the Bankruptcy Law, assets which do not belong to the bankrupt shall be exempted from the bankruptcy estate.

Segregation of client assets is also carried out at the level of accounts operated by a settlement institution, which is a function performed by the Central Securities Depository of Poland, which in turn requires participants of the Central Securities Depository of Poland to separate assets held by their clients. Pursuant to Article 57.2 of the Act on Trading in Financial Instruments, the balances on securities accounts and omnibus accounts kept by the participants should correspond to the balance on a relevant deposit account kept by the Central Securities Depository of Poland (deposit accounts do not enable the identification of the holder of the account in which securities are recorded; only securities accounts enable the identification of beneficial owners of securities).

Furthermore, Article 57a of the Act on Trading in Financial Instruments refers to the segregation of derivatives admitted to organised trading which are recorded in:

- 1) clearing accounts maintained by the clearing entity,
- 2) derivatives accounts and records maintained by participants of clearing entities.

Pursuant to Article 57a(2) of the Act on Trading in Financial Instruments, the balances in derivatives accounts and records maintained by participants of clearing entities should match the balances in the relevant clearing accounts maintained by the clearing entity.

In the context of the exemption of assets which do not belong to the bankrupt from the bankruptcy estate, it should also be noted that Article 67 of the Act on Trading in Financial Instruments provides that the assets of the default fund (which secures the clearing of transactions made on the organised trading and non-organised trading) are a joint property of the participants. According to the Act, Article 45e of the Act on Trading in Financial Instruments applies respectively to such funds, i.e. initiating bankruptcy, recovery, enforcement or liquidation proceedings as well as taking other legal measures against participants being joint owners of such funds, which result in the suspension or termination of their making debt payments or which result in the limitation of their capability to freely dispose of their property, shall not produce legal consequences concerning the funds.

Asset segregation allows for the above mentioned mechanisms to be used in the event of initiating bankruptcy, recovery, enforcement or liquidation proceedings as well as taking other legal measures against participants. It should also be noted that Article 45h.14 of the Act on Trading in Financial Instruments provides that, in the event of a declaration of bankruptcy of a clearing entity, Article 85 of Bankruptcy Law (which introduces close-out netting) shall apply respectively to transactions cleared through novation. According to Article 85 of the Bankruptcy Law, if a frame agreement, to which the bankrupt is a party, stipulates that specific contracts for futures, financial instrument lending or financial instrument buybacks shall be concluded within the frame agreement and that the termination of the frame agreement shall result in the termination of all specific contracts concluded within the frame agreement:

- 1) the claims arising under the specific contracts concluded within the frame agreement shall not be included in the arrangement; and
- 2) the trustee shall not have the right, referred to in Article 98, to renounce the frame agreement. Either party may terminate the frame agreement, subject to the settlement of accounts between the parties, as set forth in the agreement. A setoff of the claims resulting from the settling of accounts between the parties is admissible. Articles 98 and 99 (which authorise the trustee to request performance of selected agreements to which the bankrupt is a party or to rescind selected agreements, also known as cherry-picking) shall not apply to specific contracts for futures, financial instrument lending or financial instrument buybacks, even if they were not concluded within the frame agreement.

A relevant clause is used within the OTC clearing system in the participation agreement (which is a frame agreement within the meaning of Article 85 of the Bankruptcy Law) in order to minimise risk to participants and to KDPW_CCP S.A. arising from financial transactions cleared in the OTC clearing system and from payments made within the system. The clause included in KDPW_CCP regulations applies in the event of termination of a participation agreement upon the occurrence of an event of default on the part of

the participant or KDPW_CCP S.A. as defined in the Rules of Clearing Transactions (Non-organised Trading). Default events include the insolvency of a participant or the initiation of bankruptcy proceedings against KDPW_CCP S.A.

Regarding asset segregation, the following legal consequences arise for clearing system participants:

- 1) possibility of differentiation within the clearing system between positions and assets of clients and positions and assets of participants, KDPW_CCP and other clients;
- 2) no possibility of free offsetting within the clearing system of positions in separated accounts;
- 3) possibility of transferring positions together with collateral on the terms and in the events set out in the Rules of Clearing Transactions (Organised Trading and Non-organised Trading);
- 4) possibility of using margins recorded in collateral accounts only for separated clearing accounts to which these are assigned;
- 5) possibility of using the close-out netting clause in the event referred to in Article 85 of the Bankruptcy Law;
- 6) possibility for a non-clearing member being the client of a clearing member representing it in clearing to receive funds recorded in a separate collateral account remaining after the maintenance margin has been used to execute a transaction,
- 7) possibility for KDPW_CCP to use funds of a defaulting participant deposited in a deposit account, omnibus account, securities account, cash account or bank account in order to settle transactions to which it is a clearing party, especially in the event of the participant's bankruptcy.