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EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 16 November 2006

at the request of the Polish Minister for Finance on
a draft law amending the Law on trading in financial instruments

(CON/2006/53)

Introduction and legal basis

On 29 September 2006 the European Central Bank (ECB) received a request from the Polish Minister for Finance for an opinion on a number of draft laws amending Polish laws in the area of capital markets regulation[1].

The ECB's competence to deliver an opinion is based on Article 105(4) of the Treaty establishing the European Community and the third, fifth and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[2], as the draft laws relate to Narodowy Bank Polski (NBP), payment and settlement systems and rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Scope of the consultation and purpose of the draft law

1.1 The aim of the draft laws is to transpose a number of Community directives into the Polish legal system and to make certain other amendments that do not directly relate to implementation requirements.

1.2 This opinion is limited to one of the draft laws submitted for consultation, namely the draft law amending the Law on trading in financial instruments (hereinafter the 'draft law'), which implements the Directive on markets in financial instruments (MiFID)[3] and the Capital Adequacy

1 The proposed amendments affect the Law of 29 July 2005 on trading in financial instruments (Dz.U. 2005, No 183, Item 1538, as amended), the Law of 29 July 2005 on public offerings and the conditions for admitting financial instruments into the organised system of trading and on public companies (Dz.U. 2005, No 184, Item 1539, as amended) and the Law of 24 May 2004 on investment funds (Dz.U. 2004, No 146, Item 1546, as amended).

2 OJ L 189, 3.7.1998, p. 42.

3 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/EC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1). Directive as last amended by Directive 2006/31/EC (OJ L 114, 27.4.2006, p. 60).

Directive[4]. Furthermore, this opinion is limited to those provisions of the draft law that do not directly relate to the implementation of Community directives. Such provisions of the draft law primarily involve:

(i) the introduction of a system for licensing and supervising the entities operating in the field of securities clearing and settlement[5]; and

(ii) the streamlining of supervisory requirements for banks conducting brokerage activities[6].

2. Provisions relating to securities clearing and settlement

2.1 Currently, the sole securities clearing and settlement operators in Poland are: (i) the state-controlled National Depository for Securities (*Krajowy Depozyt Papierów Wartościowych*, KDPW)[7]; and (ii) NBP, for certain types of securities[8]. The draft law proposes to introduce a system of licensing and supervision for other clearing and settlement operators in Poland. This proposal relates indirectly to the requirements laid down in Article 34(2) and Article 46 of MiFID, which effectively allow the Polish operators of regulated securities markets and participants in such markets to designate qualified entities established in other Member States as providers of clearing and settlement services. Under the current Polish regime, such designation could only relate to KDPW or clearing and settlement operators established in Member States other than Poland. As a result of the proposed amendments, it will be possible for new clearing and settlement operators to be established in Poland and be designated as providers of clearing and settlement services[9]. KDPW will remain exclusively entitled to register the securities and to act as the central securities depository.

2.2 The ECB welcomes this proposal to broaden the category of entities entitled to offer clearing and settlement services in Poland and makes a number of comments below on the specific provisions of the draft law in this regard.

2.3 *Definition of clearing and settlement services*

The ECB recommends adding certain new elements in the definitions of clearing and settlement services proposed by the draft law[10]:

(i) The definition of 'clearing' in the current version of the draft law includes the phrase 'determining the value of monetary and non-monetary obligations resulting from the

4 Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast) (OJ L 177, 30.6.2006, p. 201).

5 Article 1(22)-(35) of the draft law.

6 Article 1(70)-(73) of the draft law.

7 KDPW is owned in equal parts by the State Treasury, the Warsaw Stock Exchange and NBP.

8 NBP may register and settle transactions in securities (i) issued by itself or by the State Treasury; or (ii) incorporating derivative rights based on such securities (Article 49 of the Law on trading in financial instruments; cf. Article 45c of the Law on trading in financial instruments following the amendments introduced by Article 1(24) of the draft law).

9 Cf. the explanatory memorandum to the draft law, p. 2.

10 Article 45b of the Law on trading in financial instruments, as added by Article 1(24) of the draft law.

transactions entered into [by the parties]'. The definition should be expanded to include essential elements such as transmitting, reconciling and, in some cases, confirming payment or securities transfer orders prior to settlement, possibly including the netting of orders and the establishment of final positions for settlement[11].

(ii) The definition of 'settlement' in the current version of the draft law includes the phrase 'debiting or crediting the [securities] deposit account or securities account … in connection with, respectively, disposal or acquisition of financial instruments, as well as debiting or crediting the bank account specified by the clearing participant, with the relevant values of liabilities determined as part of the clearing'. This definition should also reflect the purpose of securities settlement as the final step in a transaction or in the processing within a transfer system, the aim of which is to discharge participants from their obligations through the transfer of securities and/or funds[12].

2.4 *Operation of securities clearing and settlement*

The draft law allows a single entity to provide both clearing and settlement services[13]. Although the draft law does not specifically mention central counterparty (CCP) clearing services, in relation to any case where CCP clearing services and settlement services are provided by the same legal entity, which bears the credit risk, the ECB confirms the validity of remarks made in its report entitled 'Assessment of accession countries' securities settlement systems'[14]: 'for the sake of financial stability, a [securities settlement system (SSS)] ought as far as possible to be designed as a service provider free of credit risk. The most effective way to ensure a credit risk-free environment is the establishment of distinct legal entities to manage the risk of securities clearing and securities settlement. The idea is to create a legal structure which prevents any spillover of risks from the entity providing CCP services to the entity providing SSS services. This may also take the form of a holding structure with the CCP and SSS as affiliates, provided that the SSS's own capital remains unaffected if the CCP defaults'.

2.5 The draft law lists in detail KDPW's tasks relating to ensuring the proper operation of the clearing and settlement process. The ECB recommends that such tasks should also apply to other system operators which may be established in Poland[15]. Relevant clarification may also be needed to

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11 The proposed reformulation of the definition follows the wording developed by the Committee on Payment and Settlement Systems of the Bank for International Settlements (BIS), as most recently referred to in 'Payment and settlement systems in selected countries', April 2003, p. 485; publication available on the Bank for International Settlements' website at www.bis.org. Cf. European Central Bank, 'Payment and securities settlement systems in the European Union', June 2001, pp. 729 and 749; publication available on the ECB's website at www.ecb.int.

12 Cf. European Central Bank, 'Business continuity oversight expectations for systematically important payment systems (SIPS)', June 2006, p. 13; publication available on the ECB's website at www.ecb.int.

13 Article 68a(11) of the Law on trading in financial instruments, as added by Article 1(35) of the draft law.

14 January 2004, p. 17. Report available on the ECB's website at www.ecb.int.

15 To that end, Article 68a(1)-(2) of the Law on trading in financial instruments (as amended by Article 1(35) of the draft law) should make reference to the relevant provisions of Article 48 of the Law on trading in financial instruments (as amended by Article 1(26) of the draft law).

ensure the proper functioning of the investor compensation scheme, as currently administered by KDPW in addition to its clearing and settlement tasks[16].

2.6 The amended provisions of the Law on trading in financial instruments[17] should require that in order to mitigate operational risk the system operator should include rules on business continuity measures and secondary sites as a prerequisite for obtaining a licence. Such measures should in particular include: (i) contingency procedures to ensure the sustainability of critical functions, particularly in the event of disruption of the telecommunications network; (ii) arrangements for information dissemination in the event of a crisis; and (iii) other business continuity arrangements, including a second processing site with independent critical infrastructure components to those used at the primary site. Applicant operators should be expected to have a well-defined business continuity strategy in place, including plausible risk scenarios. At the same time, appropriate arrangements for business continuity training for the staff of system operators and system participants should be ensured. Business continuity processes and test results should be subject to periodic updates and security reviews by auditors.

2.7 *Supervision and insolvency protection*

NBP's supervisory role is currently exercised in relation to KDPW through: (i) the participation of an NBP representative in the authority supervising clearing and settlement systems (the Financial Supervision Commission)[18]; and (ii) NBP holding a substantial share in KDPW's registered capital, allowing NBP to exercise control pursuant to the relevant corporate law provisions (such as representation on KDPW's supervisory board). The draft law retains and even strengthens NBP's position in relation to KDPW in this respect, inter alia by introducing a requirement to obtain the NBP President's opinion in relation to proposed changes to KDPW's rules and the rules of the settlement guarantee fund[19].

2.8 The ECB further notes that NBP's supervisory role in relation to other clearing and settlement systems which may be established in Poland will obviously be limited to public supervisory powers (as opposed to rights stemming from the ownership of shares). The ECB therefore welcomes the NBP's President's power to issue an opinion: (i) before a licence for operating a system is granted; and (ii) before the system rules are adopted or amended[20]. Such powers will not, however, be sufficient to maintain the level of supervisory powers currently exercised by NBP in relation to KDPW. Hence, the ECB reiterates the observation made in ECB Opinion CON/2006/15[21] regarding

16 See Article 48(1)(6) of the Law on trading in financial instruments (as amended by Article 1(26) of the draft law), in conjunction with Articles 133-146 of the Law on trading in financial instruments (as amended by Article 1(86)-(91) of the draft law).

17 Article 68c(2) and (3) of the Law on trading in financial instruments, as added by Article 1(35) of the draft law.

18 Article 5(2) of the Law of 21 July 2006 on supervision of the financial market (Dz.U. 2006, No 157, Item 1119).

19 Articles 50(2) and 66(2) of the Law on trading in financial instruments, as amended by Article 1(28) and (32) of the draft law.

20 Articles 68a(4) and 68c(1) of the Law on trading in financial instruments, as added by Article 1(35) of the draft law.

21 See paragraphs 4.1-4.3 of ECB Opinion CON/2006/15 of 9 March 2006 at the request of the Polish Minister of Finance on a draft law on the supervision of financial institutions.

the need to ensure NBP's responsibility for the oversight function in relation to securities clearing and settlement. An oversight function is inherent in the central banks' task of promoting a sound market infrastructure, in order to safeguard the effectiveness of monetary policy and the overall stability of the financial system[22]. Hence, the ECB recommends that NBP is expressly made responsible for the oversight of all securities clearing and settlement systems operating in Poland, including the systems' rules, and given access to all information and data relevant to the performance of such oversight tasks.

2.9 The non-exhaustive list of insolvency-related measures that, under the terms of the draft law, do not affect the ability to pay or transfer securities[23] should include an express reference to moratoria on payments imposed on supervised entities by the supervisory authority. The ECB further understands that such insolvency-related measures have no effect on either instruments or cash held as collateral in the accounts of the affected participant with the system, and this should be clarified in the draft law.

2.10 The ECB notes the amendments introduced by the draft law into the Law on settlement finality, which implements the Settlement Finality Directive in Poland[24]. The amended provisions of the Law on settlement finality should expressly cover clearing systems as well as settlement systems. The main aim of expressly extending the settlement finality rules to clearing systems would be to protect the transfer orders and netting that take place in those systems. Further, the Law on settlement finality should make an express reference to the NBP President's power to issue an opinion before licensing a new settlement system[25]. It would be appropriate for this provision to exclude KDPW, for the sake of clarification, from the duty to apply for such a licence (as, taken literally, the proposed provision could be interpreted as requiring the suspension of KDPW's activities until an appropriate licence is issued).

3. Provisions relating to banks conducting brokerage activities

3.1 The ECB notes that the draft law also aims to streamline the special supervisory regime relating to banks conducting brokerage activities. The proposed amendment will discontinue the two sets of separate supervisory requirements applied in relation to banking and brokerage activities of such

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22 Cf. paragraph 3.2 of ECB Opinion CON/2006/20 of 25 April 2006 on the Dutch draft law concerning financial sector supervision and ECB Opinion CON/99/19 of 20 January 2000 at the request of the Luxembourg Ministry for the Treasury and the Budget on a draft legislative proposal implementing Directive 98/26/EC on settlement finality in payment and securities settlement systems in the law of 5 April 1993, as amended, relating to the financial sector and completing the law of 23 December 1998 creating a commission in charge of the prudential supervision of the financial sector; cf. BIS Committee on Payment and Settlement Systems, 'Central Bank Oversight of Payment and Settlement Systems', May 2005, p. 1; publication available on the BIS website at www.bis.org.

23 Article 45e(1) of the Law on trading in financial instruments, as added by Article 1(24) of the draft law.

24 Article 15(2) of Law of 24 August 2001 on settlement finality in the payment and settlement systems and on the supervision of such systems (Dz.U. 2001, No 123, Item 1351, as amended), as amended by Article 3(3) of the draft law. The provisions implement Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ L 166, 11.6.1998, p. 45).

25 To be included in Article 16(2) of the Law on settlement finality, as amended by Article 3(4) of the draft law.

banks[26]. This will imply, inter alia: (i) discontinuing the requirement to make initial capital for brokerage activities separate from initial capital for banking activities; (ii) discontinuing the requirement to prepare two sets of separate accounting records and financial statements; and (iii) limiting the capital adequacy requirements for banks conducting brokerage activities to requirements relating to the banking activity of such banks. The explanatory memorandum to the draft law justifies these measures as being consistent with supervisory practice, since banks conducting brokerage activities are subject to rigorous prudential supervision in relation to their banking activity[27]. Hence, rather than increasing the safety of banks' customers, the current duplicated supervisory functions have been deemed to create unnecessary impediments to banks' conduct of brokerage activities. The explanatory memorandum further notes that the duplication of supervisory requirements in such cases is not required under Community law.

3.2 The ECB recognises that credit institutions authorised under the Banking Directive[28] should not require another authorisation under MiFID to provide investment services or perform investment activities. When a credit institution decides to provide investment services or perform investment activities, the competent authorities should verify that it complies with the relevant provisions of MiFID before granting an authorisation.

3.3 However, although there is no requirement to obtain a separate authorisation, certain provisions of MiFID still apply to credit institutions when providing one or more investment services or performing investment activities[29]. The streamlining of the capital market supervision of credit institutions conducting brokerage activities does not reduce the need to ensure the proper implementation and application of MiFID provisions relating to credit institutions.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 16 November 2006.

[signed]

The President of the ECB

Jean-Claude TRICHET

26 Article 1(70)-(73) of the draft law, amending Articles 111-113 of the Law on trading in financial instruments.

27 See the explanatory memorandum to the draft law, p. 7.

28 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (OJ L 177, 30.6.2006, p. 1).

29 The following provisions of MiFID apply to credit institutions: (i) Article 2(2), 11, 13 and 14; (ii) Chapter II of Title II, excluding the second subparagraph of Article 23(2); (iii) Chapter III of Title II, excluding Articles 31(2) to 31(4) and 32(2) to 32(6), 32(8) and 32(9); (iv) Articles 48 to 53, 57, 61 and 62; and (v) Article 71(1).