EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 21 May 2008

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

(CON/2008/20)

Introduction and legal basis

On 28 February 2008 the European Central Bank (ECB) received a request from the Polish Minister for Finance for an opinion on draft legislative provisions amending Polish laws in the area of capital market 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 law relates to Narodowy Bank Polski (NBP), to payment and settlement systems and to 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. The purpose of the draft law and the scope of the consultation

1.1 The legislative package subject to the current ECB consultation will transpose a number of Community directives into the Polish legal system[3] and make other amendments that do not directly relate to implementation requirements. The ECB was already consulted on draft provisions contained in the legislative package in 2006[4]. Currently, the consulting authority has requested an ECB opinion on certain new amendments and provisions which have been proposed since the time

1 The proposed amendments are divided into three separate draft laws: (i) draft law amending the Law of 29 July 2005 on trading in financial instruments (Dz.U. 2005, No 183, item 1538, as amended) and other legislation; (ii) draft law amending 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 (iii) draft law amending 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 The implemented Directives include: (i) 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); (ii) 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); and (iii) other Community directives (2004/25/EC, 2004/109/EC, 2006/73/EC, 2007/14/EC and 2004/16/EC).

4 See ECB Opinion CON/2006/53 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.

of the original ECB consultation[5]. The present ECB opinion is limited to one of the draft laws submitted with the current consultation request (hereinafter, the 'draft law'), which is amending the Law of 29 July 2005 on trading in financial instruments (hereinafter, the 'current Law on trading in financial instruments')[6] and other legislation, including the Law of 24 August 2001 on settlement finality in payment and settlement systems and on the supervision of such systems (hereinafter, the 'Law on settlement finality')[7].

1.2 The draft law introduces new elements *inter alia* as regards the following issues related to securities clearing and settlement: (i) Krajowy Depozyt Papierów Wartościowych (KDPW, the Polish central securities depository and settlement system) is to change its shareholder structure in that NBP will be obliged to dispose of its shares currently possessed in KDPW[8]; (ii) in view of the forced sale of KDPW shares, NBP's oversight powers over KDPW will be reduced, while NBP will obtain certain limited consultation and information powers in relation to KDPW and other clearing and settlement operators, as a result of the proposed public law provisions[9]; and (iii) outsourcing of KDPW's activities to third parties is to be restricted[10]. Additionally, the statutory definition and procedure for recognition of payment and settlement systems[11] and licensing requirements for banks conducting brokerage activities[12] are amended.

2. General remarks

The ECB would like to reiterate its comments in Opinion CON/2006/53 to the extent they have not been incorporated in the current version of the draft law, particularly on the following: (i) the need to adapt the statutory definitions of 'clearing' and 'settlement' to standards developed by the Committee on Payment

5 Such amendments were either added in the text of the legislative draft submitted to the Parliament (Sejm) following ECB Opinion CON/2006/53 (see Sejm document No 64) or are proposed in the separate Governmental submission of 15 February 2008, complementing the original draft.

6 See publication references in the footnote 1 above.

7 Dz.U. 2001, No 123, item 1351, as amended. One of the other laws subject to the amendmnets proposed by the draft law is the Law on banking of 29 August 1997 (consolidated text: Dz.U. 2002, No 72, item 665, as amended).

8 See Article 46 of the Law on trading in financial instruments following the amendments introduced in this Law by Article 1(37) of the draft law, as amended by point 1(15) of the Governmental submission of 15 February 2008, and by Article 18a of the draft law, as added by point 8 of the abovementioned Governmental submission.

9 See Articles 48(16), 50(2), 64a, 68a(5) and 68b(1) of the Law on trading in financial instruments following the amendments introduced in this Law by Article 1(38), (50a), (51a) (added by point 1(22) of the Governmental submission of 15 February 2008) and Article 56 of the draft law.

10 The draft law will allow KDPW only to outsource to its own subsidiaries. See Article 48(7) to (15) of the Law on trading in financial instruments following the amendments introduced in this Law by Article 1(38) of the draft law, as partially amended by point 1(17) of the Governmental submission of 15 February 2008.

11 In certain cases, in view of the systemic risk considerations, the following competence will be given to NBP's President in relation to payment systems and to the Financial Supervision Commission in relation to securities settlement systems: (i) recognition of arrangements involving only two participants as a 'system'; and (ii) recognition of indirect participants as participants in the system; see Articles 2 and Articles 2a and 17a and Article 19 of the Law on settlement finality following the amendments introduced in this Law by Article 13(1)-(2a), (7a) and (9) of the draft law, as partially amended by point 4 of the Governmental submission of 15 February 2008.

12 In particular, certain amendments will be introduced to the applicant bank's initial capital and the organisational separation of banking and brokerage activities; see Article 111 of the Law on trading in financial instruments following the amendments introduced in this Law by Article 1(96) of the draft law, as amended by point 1(44) of the Governmental submission of 15 February 2008.

and Settlement Systems (CPSS) of the Bank for International Settlements (BIS) and by the ECB[13]; (ii) the need to prevent spillover of risks from the entity providing central counterparty services to the entity providing security settlement services[14]; (iii) the need to assign tasks related to ensuring proper operation of the clearing and settlement process not only to KDPW but also to other clearing or settlement system operators which may be established in Poland[15]; (iv) the need for clearing and settlement system operators to submit rules on business continuity measures and on secondary sites as a prerequisite for obtaining a licence[16]; and (v) the need to ensure express coverage of clearing houses under the provisions of the Law on settlement finality[17]. The ECB recommends taking into account past ECB comments at the current stage of the legislative work, in addition to the more detailed remarks presented below.

3. Central bank ownership and oversight of securities clearing and settlement systems

3.1 At present, the sole securities clearing and settlement operators in Poland are: (i) KDPW; and (ii) NBP, for certain types of securities[18]. KDPW, which performs a whole range of depository and settlement functions, is owned in equal parts by the State Treasury, the Warsaw Stock Exchange and NBP[19]. KDPW is supervised by the Financial Supervision Commission (FSC)[20] and is also subject to oversight exercised by NBP through: (i) participation of one NBP representative in the FSC[21]; and (ii) wide corporate-law control measures available to NBP due to its holding of KDPW shares, such as being represented in KDPW Supervisory Board[22] and exercising rights available to the Supervisory Board members[23].

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13 See paragraph 2.3 of ECB Opinion CON/2006/53, as currently relating to Article 45b of the Law on trading in financial instruments, as amended by Article 1(36) of the draft law.

14 See paragraph 2.4 of ECB Opinion CON/2006/53, as currently relating to Article 68a(11) of the Law on trading in financial instruments, as amended by Article 1(56) of the draft law.

15 See paragraph 2.5 of ECB Opinion CON/2006/53, as currently relating to Article 48 and Article 68a(1) to (2) of the Law on trading in financial instruments, as amended by Article 1(33) and (56) of the draft law.

16 See paragraph 2.6 of ECB Opinion CON/2006/53, as currently relating to Article 68c(2) to (3) of the Law on trading in financial instruments, as amended by Article 1(56) of the draft law.

17 See paragraph 2.10 of ECB Opinion CON/2006/53, as currently relating to Article 15(1) to (2) of the Law on settlement finality, as amended by Article 13(5) of the draft law.

18 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 current Law on trading in financial instruments; cf. Article 45c of the Law on trading in financial instruments following the amendments introduced by Article 1(36) of the draft law).

19 See the KDPW Annual Report 2006, p. 6 and its English translation available on KDPW's website at www.kdpw.com.pl.

20 See Article 5(6) of the Law of 29 July 2005 on supervision of the capital market (Dz.U. 2005 No 183, item 1537, as amended, hereinafter the 'Law on supervision of the capital market').

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

22 KDPW Supervisory Board comprises six to nine members appointed for a three-year term by KDPW Shareholders' General Meeting (see paragraph 15 of the KDPW Statute, as last amended by Resolution No 5/2007 of the KDPW Extraordinary General Shareholders' Meeting of 22 August 2007, hereinafter, the 'KDPW Statute' (available with its English translation on KDPW's website at www.kdpw.com.pl)).

23 The KDPW Supervisory Board continuously monitors KDPW's activities. The responsibilities of the Supervisory Board include, *inter alia*: (i) review of KDPW financial statements and KDPW Management Board accounts; (ii) suspension of Management Board members from their duties; (iii) adopting the KDPW Rules, the Rules of the KDPW Settlement Guarantee Fund and the Rules of the Investor Compensation Scheme; (iv) appointing a certified auditor; (v) approving the KDPW business plans and financial plans; and (vi) approving the establishment of KDPW subsidiaries (see paragraph 20 of the KDPW Statute).

3.2 Article 18a of the draft law requires NBP to dispose of its shares held in KDPW's capital within 12 months of the draft law's entry into force. If NBP does not dispose of its shares in KDPW, the sanction of not being able to exercise shareholder rights would apply to NBP. This would result in NBP losing its current oversight powers over KDPW stemming from its rights as a KDPW shareholder. The explanatory memorandum to the draft law suggests that such discontinuation of NBP's oversight powers exercised on the basis of its shareholder status may be compensated by the assignment of certain public law competences to the NBP, as proposed by the draft law[24]. It proposes that the NBP President will have a right to issue a non-binding opinion on: (i) the KDPW rules and amendments to such rules, presented to the FSC for approval, to the extent such rules concern clearing and settlement of transactions in financial instruments; and (ii) within the same scope – rules of KDPW's subsidiaries conducting securities clearing and settlement functions delegated by KDPW and rules of other clearing houses or settlement houses, established on the basis of the Law on trading in financial instruments, once it is amended[25]. Further, at the NBP President's request, members of the KDPW management and staff will be obliged to disclose in writing information regarding KDPW's activities related to the clearing and settlement of transactions in financial instruments[26].

3.3 *Central bank financial independence*

The ECB wishes to point out that the concept of central bank financial independence in Article 108 of the Treaty should be seen from the perspective of whether any third party is able to exercise either direct or indirect influence over the ability of the national central bank (NCB) to fulfill its mandate[27]. The draft law does not comply with the principle of central bank independence as it forces NBP to dispose of its assets, namely all its shares held in KDPW. The ECB is of the view that the NBP's shareholder status may be modified, if and when needed, in agreement with the NBP's decision-making bodies, at the market price.

3.4 *Recognition of NBP's oversight functions*

The ECB understands that the draft law does not substantially affect NBPs' supervision of payment systems under the Law on settlement finality[28]. However, the draft law foresees express specification of certain NBP's oversight powers over securities clearing and settlement systems. As recalled in previous ECB opinions, an oversight function is inherent in the central bank task of promoting a sound market infrastructure, in order to safeguard the effectiveness of monetary policy

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24 See page 53 of the explanatory memorandum to the Governmental submission of 15 February 2008. The ECB understands that the assignment to NBP of certain public law oversight competences was already proposed in the version of the draft law consulted in 2006, whereby it was not linked with the proposal to force NBP's sale of KDPW shares.

25 The NBP President may also issue a non-binding opinion on the operating licence to be given by the FSC to such clearing houses and settlement houses (see provisions referred to in footnote 9 above).

26 See new Article 64a of the Law on trading in financial instruments, introduced by Article 1(51a) of the draft law, added by point 1(22) of the Governmental submission of 15 February 2008.

27 See paragraph 9 of ECB Opinion CON/2004/16 of 11 May 2004 at the request of the Italian Ministry of Economic Affairs and Finance on a draft law on the protection of savings.

28 See Article 16(1) and (3) and Articles 17 to 19 of the Law on settlement finality. As a result of provisions introduced by the draft law, the NBP President will obtain certain new competences relating to the recognition of arrangements involving only two participants as a 'system' (see provisions listed in footnote 11 above).

and the overall stability of the financial system[29]. It should be recognised in this context that payment systems and security settlement systems (SSSs) are interlinked given the use of the mechanism of 'delivery versus payment' under which settlements of securities and transfers of funds take place simultaneously. There is therefore a strong argument for integrating the oversight of payment and securities settlement systems, and for the NCB to perform this function. Settlement of both legs of such transactions should be subject to similar safeguards to avoid asymmetries with systemic implications. The role of NCBs in SSS oversight is evident given SSSs' crucial role in the functioning of the financial markets and, therefore, the need for them to be safe and efficient. Oversight of payment and clearing systems is one of the core competencies attributed to the Eurosystem, with its legal basis specified in Article 105(2) of the Treaty and Article 3.1 and Article 22 of the Statute of the European System of Central Banks and of the European Central Bank[30]. In particular, the Eurosystem central banks perform oversight of payment systems in line with the common oversight policy defined by the Governing Council, which will also apply to NBP once Poland adopts the euro[31]. As noted in previous ECB opinions[32], the central bank oversight role is also reflected: (i) at international level, in the joint work on SSSs concluded by the CPSS and the International Organization of Securities Commissions (IOSCO)[33]; and (ii) at Community level, in the joint work of the ESCB and the Committee of European Securities Regulators (CESR) in establishing common standards for EU SSSs[34], the mandate for which has recently been reaffirmed by the Council[35].

3.5 The ECB further notes that in the particular case of NBP's oversight of KDPW the need to ensure the effectiveness of the oversight functions is supported by the systemic importance of KDPW in maintaining financial market stability in Poland, by the key role of KDPW settlement services in the operations implementing NBP's monetary policy and by the close operational link between KDPW and the NBP-operated payment systems, including the SORBNET-EURO system connected with the Eurosystem's TARGET system[36]. In view of the above, the ECB recommends

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29 Paragraph 2.8 of ECB Opinion CON/2006/53; cf. paragraph 3.2 of ECB Opinion CON/2006/20 of 25 April 2006 on the Dutch draft law concerning financial sector supervision and paragraphs 4 to 14 of ECB Opinion CON/1999/19 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 [title shortened]; cf. CPSS, 'Central Bank Oversight of Payment and Settlement Systems', May 2005, point 1.1; publication available on the BIS website at www.bis.org.

30 See paragraph 5 of ECB opinion CON/2003/14 of 7 August 2003 at the request of the Banca d'Italia on a draft regulation on payment systems, payment infrastructures and payment instruments.

31 Cf. paragraph 14 of ECB Opinion CON/2005/24 of 15 July 2005 at the request of the Ministry of Finance of the Czech Republic on a draft law on the integration of financial market supervisors; see also paragraph 4.2 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.

32 Cf. paragraph 15 of ECB Opinion CON/2005/24.

33 See e.g. joint CPSS-IOSCO publications 'Recommendations for securities settlement systems', November 2001 and 'Recommendations for Central Counterparties', November 2004; publications available on the BIS website at www.bis.org.

34 See e.g. joint ESCB-CESR publication 'Standards for securities clearing and settlement in the European Union', September 2004; publication available on the ECB website at www.ecb.europa.eu.

35 See the informal ECOFIN Council meeting of 4 to 5 April 2008, 'EU financial markets infrastructures', point 3; publication available on the website of the Slovenian Presidency of the EU at www.eu2008.si.

36 The SORBNET-EURO is soon to be replaced by TARGET2-NBP system.

that the Polish authorities adopt solutions ensuring NBP's capacity to perform its oversight tasks, including in particular meaningful and direct access by NBP to information relevant for the performance of its financial stability role and NBP's long-term capacity to ensure the smooth functioning of the payment and settlement infrastructure relevant to its monetary policy and intraday credit operations. In particular, the ECB makes the following comments:

(i) The ECB reiterates its earlier recommendation[37] for NBP to be expressly made responsible, as one of its tasks, for the oversight of all securities clearing and settlement systems that operate or will operate in Poland, including the systems' rules, and given access to all information and data relevant to the performance of such oversight tasks. In this context, the ECB also draws the Polish legislator's attention to the following provisions proposed by the draft law: (i) Article 64a of the Law on trading in financial instruments[38], which requires only KDPW and not any other operators to provide NBP with information in writing as regards their clearing and settlement activities; and (ii) Article 2(2) of the Law on settlement finality[39], which does not provide for any NBP involvement in the exercise of the competence to recognise the legal arrangements between two participants as securities settlement systems.

(ii) It needs to be further considered how the NBP's oversight competences should be adequately exercised in cooperation with the FSC exercising its supervisory competences on the basis of the provisions amended by the draft law[40]. If other authorities have legal or other responsibilities for aspects of payment and settlement systems, central banks are open to cooperation with these authorities.

4. Delegation of securities clearing and settlement services to third parties

The ECB draws the Polish legislator's attention to the proposed provision of Article 48(7) of the Law on trading in financial instruments[41], which specifies that the listed KDPW tasks may be delegated solely to KDPW's own subsidiaries. The ECB notes that while national laws may provide for authorisation or review requirements in respect of delegating or outsourcing to third parties of the activities of the central securities depositories (CSDs) conducting settlement functions, such laws normally do not require legal dependence by the CSD on third parties to which CSD activities are delegated or outsourced. Any provisions proposed in this regard should not prejudice further evolution of the securities infrastructure in Poland, its integration with the European securities infrastructure and further market harmonisation, as it could negatively affect Polish investors and issuers.

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37 See paragraph 4.3 of ECB Opinion CON/2006/15, as also repeated in the paragraph 2.8 of ECB Opinion CON/2006/53.

38 As introduced by Article 51a of the draft law, amended by point 1(22) of the Governmental submission of 15 February 2008.

39 As introduced by Article 13(2) of the draft law, amended by point 4 of the Governmental submission of 15 February 2008.

40 See Article 16 of the draft law in the wording proposed by point 5 of the Governmental submission of 15 February 2008, amending relevant provisions of the Law on supervision of the capital market.

41 As amended by Article 1(38) of the draft law.

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

Done at Frankfurt am Main, 21 May 2008.

[signed]

The President of the ECB

Jean-Claude TRICHET