

SECURITIES LENDING & BORROWING INITIATED BY PARTICIPANTS

The Central Securities Depository of Poland

October 2014

Securities lending and borrowing initiated by participants is a system organised by KDPW in cooperation with KDPW_CCP.

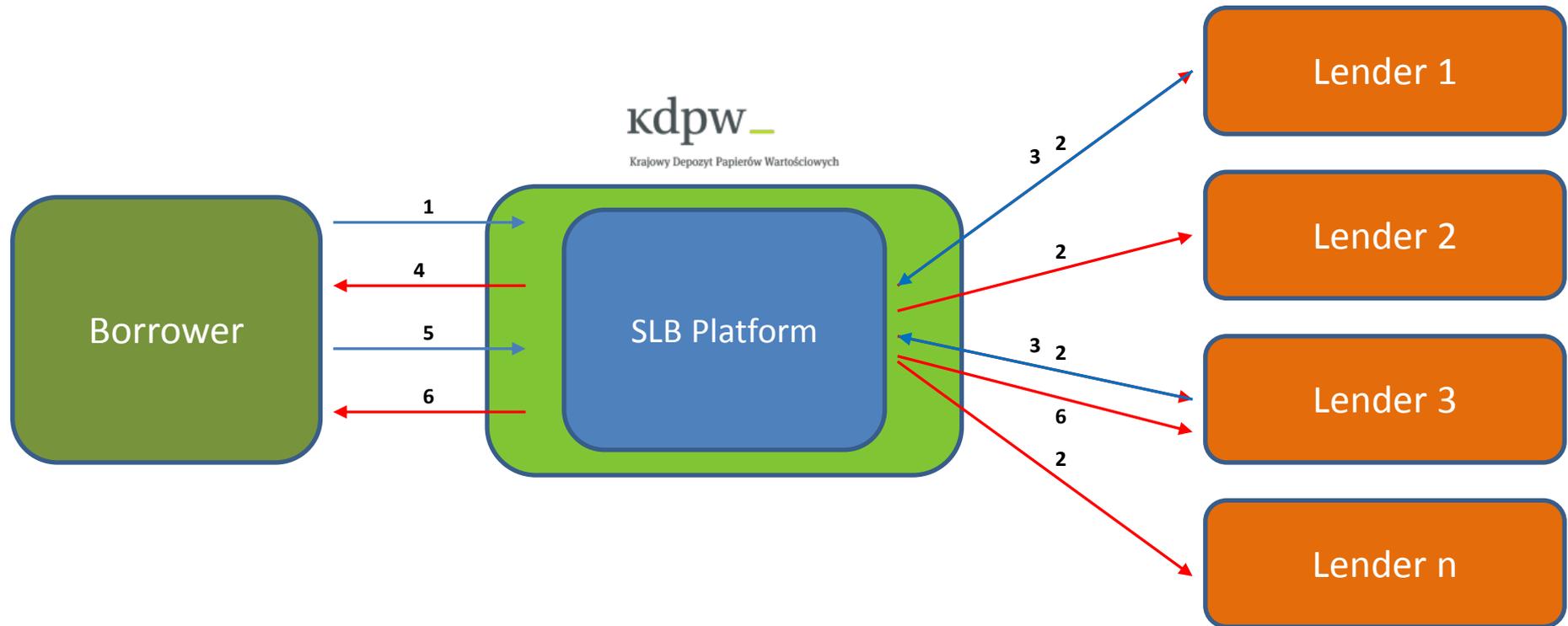
Its main objectives are:

- ✓ Reduction of settlement failure risk,
- ✓ Elimination of settlement failures resulting from trades concluded on the regulated market, or the alternative trading system organised by the WSE, secured by appropriate clearing funds,
- ✓ Securing the performance of obligations arising from securities loans concluded within the automatic securities lending and borrowing system.

Participation in the SLB system

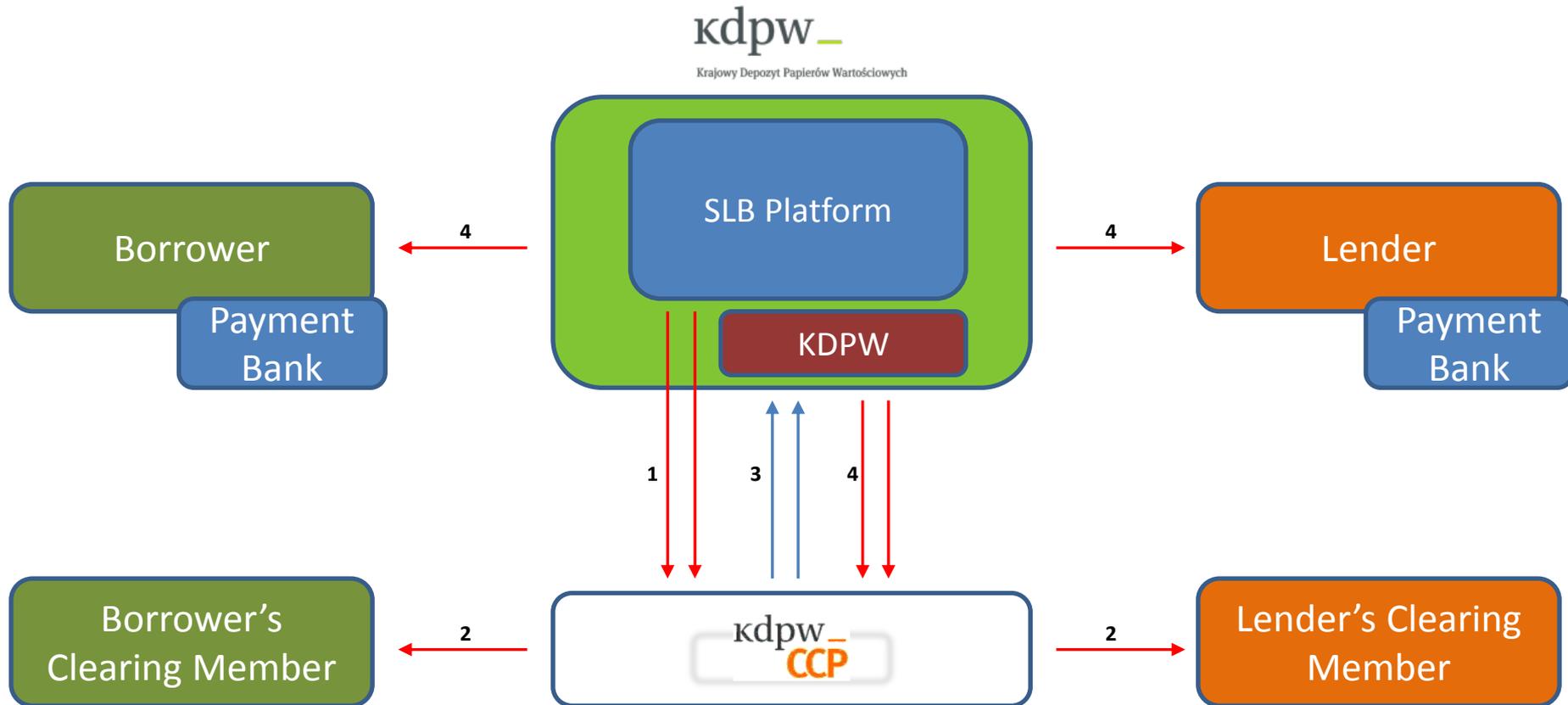
1. Participation in the system will be voluntary and available to KDPW's direct participants that declare their intent on participation, presuming that the necessary clearing arrangements are in place.
2. Participants can define their status in the system as lender and/or borrower.
3. Securities lending agreements can be concluded for house or clients' account.
4. KDPW will ensure anonymity of the parties to a securities lending agreement.
5. Securities lending agreements will be concluded, cleared and settled within the settlement guarantee system.

Securities Lending Agreement



- 1 -> Borrower submits an initial request for a securities loan,
- 2 -> Initial request details are distributed to potential lenders,
- 3 -> Lenders send their securities loan offers,
- 4 -> Securities loan offers are distributed to borrower,
- 5 -> Borrower accepts a securities loan offer,
- 6 -> Both parties receive securities loan confirmation. Lending agreement is concluded and registered.

Clearing and Settlement



- 1 -> SLB Platform generates and sends two clearing instructions to KDPW_CCP,
- 2 -> Clearing members receive information concerning their clearing obligations,
- 3 -> KDPW_CCP generates and sends two settlement instructions to KDPW,
- 4 -> KDPW settles received instructions and confirms loan opening (OPEN) or closing (CLOS).

OPEN phase – Loan opening settlement

1. Settlement of securities loans is scheduled at each multi batch session with cash settlement.
2. It is assumed that loan opening settlement will take place on T+0 or T+1 depending on the securities lending agreement.
3. The ownership of loaned securities is transferred from the lender to the borrower while the amount of the initial cash collateral is transferred from the borrower to the lender.
4. If the loan opening operation fails to settle on the scheduled date because one of the parties fails to deliver the required assets, there will be no loan opening settlement. The lending agreement will be cancelled and the party failing to deliver the required assets will be obliged to pay a compensation fee. There is no KDPW_CCP settlement guarantee for the OPEN phase.
5. KDPW_CCP manages risks associated with, and guarantees return of all opened securities loans.

Managing the collateral and the risk of a securities loan

1. KDPW_CCP will manage risks of opened securities loans and guarantee the return of the loaned securities and submitted collateral.
2. KDPW_CCP will manage a separate risk guarantee system designated for securities lending and borrowing system initiated by participants.
3. The components of the SLB risk guarantee system (initial collateral, MTM, initial margin, maintenance margin) will ensure recovery of the lender's investment portfolio (assuming normal market performance of securities).
4. The amount of maintenance margins will be updated using SPAN® methodology as for cash and forward market transactions.
5. In addition to the above mentioned components, the SLB risk management system will be extended to include a separate and additional settlement guarantee fund designed solely for securities lending and borrowing.
6. In the absence of the required amount of collateral, KDPW_CCP will terminate the loan and submit the relevant settlement instructions for settlement in KDPW.

Initial loan collateral = Loan opening value

1. Initial collateral will be cleared and settled (only in cash) using DvP (in loan opening).
2. In the absence of loan opening settlement, no initial collateral will be charged or transferred and no maintenance margins will be calculated.
3. Initial collateral will be updated each day of the loan life cycle, based on market value of the loaned securities using daily mark-to-market (MTM).

Initial collateral utilisation

1. Lender is obliged to utilise received initial collateral if:
 - ✓ Borrower fails to deliver securities for loan closing settlement,
 - ✓ Securities loan is terminated due to either:
 - Borrower failing to settle daily MTM obligations, or
 - Borrower or his clearing member fail to fulfil their clearing obligations.

2. Received initial collateral is said to be utilised by the lender, when it is delivered to KDPW_CCP in order for the CCP to perform a buy-in operation, resulting in either:
 - ✓ Returning the loaned securities to the lender, or
 - ✓ If buy-in operation is not practicable, compensating lender in cash.

Mark-to-Market (MTM)

1. Daily mark-to-market (MTM) updates the value of the initial collateral provided based on market value of loaned securities.
2. The operation is performed at the end of each business day, both for active loans as well as newly opened loans, and settled on the next business day.
3. To ensure that the value of the provided initial collateral matches the market value of the loaned securities, MTM will be settled on a daily basis, including transfers:
 - ✓ From the lender to the borrower (if the value of the loaned securities decreases), or
 - ✓ From the borrower to the lender (if the price of the loaned securities increases).

Maintenance margin

1. Margins will be contributed in cash and/or eligible securities (the purpose of the margin is to secure the risk as determined for normal conditions).
2. The amount of the maintenance margin will be calculated by KDPW_CCP and notified to KDPW_CCP clearing members.
3. KDPW_CCP will determine risk parameters to be used in the calculation of the maintenance margin of a loan portfolio.
4. The contributed margin will be updated by ongoing monitoring of the maintenance margin within the term of the loan and if required, calls to supplement the margin if the value of the collateral decreases.

SLB settlement guarantee fund

1. KDPW_CCP manages a settlement guarantee fund designed solely for securities lending and borrowing initiated by the participants.
2. The aim of the fund is to secure the performance of obligations arising from a securities loan closing phase, which includes return of the borrowed securities as well as return of the initial collateral provided (taking into account daily MTM).
3. Based on the SLB settlement guarantee fund regulations, appropriate clearing members are obliged to contribute to the settlement guarantee fund.

CLOS phase – Loan closing settlement

1. Settlement of securities loans is scheduled at each multi batch session with cash settlement.
2. Return of a loan will be guaranteed and covered by the SLB risk management system, including SLB settlement guarantee fund.
3. Loan return will be settled in KDPW. On the loan closing settlement date, the present value of the initial collateral (including daily MTM) will be debited from the lender and credited to the borrower in return for securities delivered by the borrower.

Returning a fixed-term loan:

1. A fixed-term loan will close at the end of its term. Settlement will take place on the indicated return date. Settlement instructions concerning closing will be automatically generated by kdpw_stream at the end of the day preceding the return date.
2. If parties to a securities loan submit matching settlement documents to kdpw_stream, at the latest on the day preceding the fixed-term loan closing settlement date, specifying a loan closing settlement date other than the original date, the settlement will take place on the new date.

Returning an open-term loan:

1. In case of open-term loans, securities may be returned in whole or in part by the borrower or at the request of the lender, however the parties will be bound by a fixed loan return deadline running as of the date of issue of loaned securities return instructions by the lender or by the borrower.
2. A request to close a loan may be made no earlier than the day following the loan opening settlement date with the following loan closing settlement dates:
 - ✓ T+1 – if requested by the borrower;
 - ✓ T+3 – if requested by the lender.*
3. If the parties do not request loan closing within 365 calendar days after the loan opening date, the settlement will take place automatically on T+365.

* Assuming T+2 settlement cycle, as of October 6, 2014.

Closing a loan by KDPW_CCP

1. In case of failure to return securities (by the borrower) or to return received collateral (by the lender) on the required date the loan will be closed.
2. If the collateral is not supplemented up to the required amount or is not contributed in the required form, securities loan return will take place, and if not settled, then the loan will be closed.
3. In the cases above, KDPW_CCP takes actions according to standard default procedures.

Compensation of lost benefits

1. Compensation of benefits from loaned securities lost by the lender will be processed as for automatic securities loans depending on the category of benefits:
 - ✓ For cash benefits – if the record date falls during the term of a securities loan, KDPW will charge an additional fee from the borrower to transfer it to the lender. The fee will compensate the lender for lost benefits from loaned securities in the amount of gross benefits.
 - ✓ For non-cash benefits – KDPW will not mediate in processing compensation, thus in order to exercise rights attached to securities loaned under open-term loans the lender should close the loan before the date of determining rights attached to such securities.

Lending fees

1. The borrower will be charged a lending fee. The lending fee will be calculated on a daily basis according to the formula:

$$\text{Lending fee} = \text{Present loan value} * \text{Fee rate [\%]} * 1/365$$

2. The lender will be charged interest on cash collateral. Interest will be accrued on a daily basis according to the POLONIA rate.
3. Lending fees and cash collateral interest will be charged on a daily basis and cleared between participants on a monthly basis.

Disciplinary fees

1. In case of failure to deliver assets (loaned securities or initial collateral) for loan opening settlement, the defaulting party will be charged an extra fee (e.g., 2% of the loan value subject to a minimum fee threshold). The charged fee will be transferred to the other party of the lending agreement.

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