

PROCESSING COLLATERAL IN EUR-DENOMINATED BONDS

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1. INTRODUCTION

This document describes the functionalities related to the collateral register maintained in KDPW_CCP to process EUR-denominated securities posted as collateral.

Margin and fund requirements are always determined in PLN, regardless of whether they arise from transactions cleared in PLN or EUR.

2. STATUS MESSAGE COLR.STS.001.XX

The status message colr.sts.001.xx is sent by KDPW_CCP in response to an instruction to post/release collateral colr.ins.001.xx. The status message colr.sts.001.xx is sent irrespective of the type of collateral subject to the instruction and of its currency. In addition to the status, the message for the clearing member replicates the data provided in the member's instruction. In addition, the message colr.sts.001.xx with a status indicating whether the instruction can be executed and then indicating that the instruction has been executed, together with dedicated information, is sent to the clearing member's paying agent. The following instruction statuses are available:

PEND	Instruction accepted
PENF	Instruction pending KDPW_CCP's approval or pending execution
SETL	Collateral has been posted or released
CAND	Instruction has been rejected, including the reason for the rejection

3. PROCESSING EUR-DENOMINATED SECURITIES POSTED AS COLLATERAL

4.1. Legal and organisational requirements

Securities denominated in EUR may be posted as:

- initial deposit (MARI),
- initial margin (MARS),
- OTC initial deposit (OTCL),
- OTC initial margin (OTCM),
- ATS initial deposit (MAGB),
- ATS initial margin (MATS),
- contribution to the clearing fund (PRRG),
- contribution to the OTC guarantee fund (FOTC),

- contribution to the GPW BondSpot ATS guarantee fund (PAGB).

The list of EUR-denominated securities accepted as collateral is published by KDPW_CCP.

Securities denominated in EUR are posted/released as collateral in co-operation with two foreign depositories:

- Clearstream Banking Luxembourg S.A.,
- Euroclear Bank SA/NV.

This functionality is based on the triparty collateral management mechanisms available in those depositories (Collateral Service at Euroclear and Collateral Management System at Clearstream). A clearing member intending to post EUR-denominated securities as collateral is required to be a member of one of those foreign depositories and to have signed the relevant agreement (or to have an agent in the case of Euroclear). A member should then request KDPW_CCP to designate the member to the foreign depository as a collateral receiver/collateral taker. The relationship in the foreign depository is set up on the basis of the KDPW_CCP request sent to the foreign depository.

In addition, the clearing member is required to inform KDPW_CCP of its identifier in the selected foreign depository (BIC code, account identifier).

Securities are transferred to a KDPW_CCP account in a foreign depository as a transfer of title.

4.2. Operational requirements

In order to post or release securities denominated in EUR as collateral, the clearing member sends an instruction to KDPW_CCP in a message specifying the value of the collateral to be covered by the securities held in the selected foreign depository. Both the value of the collateral and the code of the foreign depository are entered respectively in the message colr.ins.001.xx sent to KDPW_CCP. The foreign depository is defined by entering the relevant BIC code of the foreign depository: 'CEDELULL' for Clearstream (in the test environment: 'CEDELULL') and 'MGTCBEBE' for Euroclear. The fields that differentiate the message colr.ins.001.xx used when posting securities denominated in EUR from the message used for securities denominated in PLN are as follows:

- <Ccy> populated with the value EUR,
- <SfkpgPlc> populated with the BIC code of the foreign depository,
- <BIC> populated with the BIC code of the clearing member (for Clearstream) or <PrtryId> populated with the account identifier for Euroclear.

Sample message:

```
<?xml version="1.0" encoding="UTF-8"?>
<KDPWDocument Sndr="5003" Rcvr="0010" xsi:schemaLocation="urn:kdpw:xsd:colr.ins.001.xx colr.ins.001.xx.xsd"
xmlns="urn:kdpw:xsd:colr.ins.001.xx" xmlns:xsi="http://www.w3.org/2001/XMLSchema-instance">
  <colr.ins.001.xx>
    <GnlInf>
      <SndrMsgRef>mr1</SndrMsgRef>
    </GnlInf>
  </colr.ins.001.xx>
</KDPWDocument>
```

```

        <CreDtTm>
            <Dt>2019-07-03</Dt>
        </CreDtTm>
    </GnlInf>
    <CollDtIs>
        <BalTp>MARI</BalTp>
        <Ccy>EUR</Ccy>
        <SttlmDt>2019-07-04</SttlmDt>
        <CollBal>
            <Bal>5000</Bal>
            <CdtDbtInd>CRDT</CdtDbtInd>
        </CollBal>
        <ClrgMmbInf>
            <ClrgMmbld>
                <KDPWMmbld>5003</KDPWMmbld>
            </ClrgMmbld>
        </ClrgMmbInf>
        <SttlmtAgtMmbld>
            <SfkpgPlc>CEDELULL</SfkpgPlc>
            <BIC>MEGA1234</BIC>
        </SttlmtAgtMmbld>
    </CollDtIs>
</colr.ins.001.xx>
</KDPWDocument>

```

For an instruction to release securities denominated in EUR, the fields in the message are populated in the same way as when posting securities with the exception that the field <CdtDbtInd> should be populated with the value 'DBIT'.

After the clearing member has transmitted the instruction to KDPW_CCP, provided that the instruction is correct, the message colr.sts.001.xx with the status 'PEND' is sent. If the instruction is rejected, the clearing member receives a message with the status 'CAND' together with the reason for the rejection.

Next, on the settlement date specified by the participant in the message colr.ins.001.xx, KDPW_CCP transmits an order to the foreign depository specifying the exposure remaining to be collateralised. If the order is successfully set up in the foreign depository, the member receives the message colr.sts.001.xx with the status 'PENF'. If the instruction is rejected, the clearing member receives a message with the status 'CAND' together with the reason for the rejection.

If the order is executed, the title to the clearing member's securities is transferred to the KDPW_CCP account and the collateral register is updated. In this case, the member receives the message colr.sts.001.xx with the status 'SETL'. If the instruction is rejected, the clearing member receives a message with the status 'CAND' together with the reason for the rejection.

Foreign depositories operate on a total exposure basis while the KDPW_CCP standard is that the message colr.ins.001.xx specifies the posted/released value of the collateral. The KDPW_CCP system accepts the value of a change defined by the clearing member and, in communication with the foreign depository, uses the total value to be posted as collateral of all collateral types taking into account previous contributions. As a result, KDPW_CCP follows the currently used convention as to how members post and release collateral where the clearing member defines in its instructions the value to be posted or released per specific type of collateral.

Based on the criteria for acceptable securities defined by KDPW_CCP and the haircuts set by KDPW_CCP, the foreign depository selects securities from the member's pool of securities to cover the value of the collateral notified by KDPW_CCP.

Securities accepted as collateral are EUR-denominated bonds meeting the following criteria:

- the issuing country is a European Union Member State,
- the issuing country has a sufficiently high rating,
- the maturity of the security does not exceed 30 years.

According to the practice of the foreign depositories, all corporate events should be processed by the foreign depository without interference from KDPW_CCP. As a result, Clearstream and Euroclear in the Collateral Service/Management system manage the securities recorded in the KDPW_CCP account in such a way that, prior to the record day of the corporate event, the securities are automatically substituted with (converted into) other eligible assets, not subject to corporate events, in accordance with the criteria previously established by KDPW_CCP.

It should be noted that a case where a member's exposure cannot be covered by the securities it holds in a foreign depository is a serious incident and may be interpreted by the foreign depository as a near-default event. This is due to the nature of the Collateral Service/Management system where members acting as a CCP have a privileged status and may require a margin value specified by them.

The end-of-day valuation process for EUR-denominated securities differs from the valuation of cash in EUR. In both cases, the exchange rate from Bloomberg downloaded at around 17:00 is used. As in the case of cash in EUR, the previous day's FX rate is used in the valuation of EUR-denominated securities posted during the day. In contrast, the FX rates used to calculate the value (i.e., before the haircut) and the valuation (i.e. after the haircut) in PLN of EUR-denominated assets are the same in each message colr.sm1.002.xx because the haircut for securities is taken into account at the foreign depository level. The currency conversion takes place in the valuation process at KDPW_CCP.

The identification of securities denominated in EUR in KDPW_CCP uses the code of the foreign depository where the collateral has been transferred, i.e., 'CEDELULL' for Clearstream and 'MGTCBEBE' for Euroclear, respectively. The above values are presented in the field <SfkpgPlc> in colr.sm1.002.xx but there is no <ISIN> field.

Sample portion of colr.sm1.002.xx:

```
<StmntForAcct>
  <ColrDtls>
    <BalTp>MARI</BalTp>
    <SfkpgPlc>CEDELULL</SfkpgPlc>
    <MktPric>4.17</MktPric>
    <ClctdPric>4.17</ClctdPric>
    <AvlblMktVal>412830.00</AvlblMktVal>
    <AvlblClctdVal>412830.00</AvlblClctdVal>
  </ColrDtls>
  (...)
</StmntForAcct>
```