KOMISJA NADZORU FINANSOWEGO

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Investment Firms and Capital
Market Infrastructure Department
DRK/WRM/485/33/ 5 /2015/PT

Warsaw, 23 July 2015

Dear Sirs,

Pursuant to coming into force on 16 July 2015 of Article 1 point 14a of the Act on Amending the Trading in Financial Instruments Act and Other Acts of 5 December 2014 (Act on amending Act – Journal of Laws of 2015, item 73), as well as due to many queries received from investment firms regarding rules of application of this regulation, Investment Firms and Capital Market Infrastructure Department (Department) takes position with regard to financial instruments margin requirements.

Pursuant to Article 73 paragraph 2a-2c of the Act on Trading in Financial Instruments of 29 July 2005 (Act on Trading), investment firm executes orders to buy or sell financial instruments, mentioned in Article 2 paragraph 1 point 2(c-i) of the Act on Trading, not cleared by the CCP, placed by individual client, provided that margin required for given financial instrument is not less than 1% of the nominal value of financial instrument.

There is an exception to this regulation in Article 73 paragraph 2b of the Act on Trading – the case of orders to sell options resulting in issuing of options. In this situation, required margin should be not less than the premium calculated by the investment firm, using recognised option pricing model which is made available to individual client, increased by 1% of the nominal value of option.

While analysing and interpreting abovementioned regulations, it is important to understand their specific character. Regulations of Article 73 paragraph 2a-2c of the Act on Trading are dedicated to specific financial instruments – derivatives. This is crucial, because specific nature of derivative trading, which in many aspects (e.g. execution of orders) differs from trading of other financial instruments (e.g. securities), must be considered to understand those regulations.

Additionally, it is important to consider the aim of those regulations. One of the main tenets was mitigation of individual client's risk while investing in high-leverage derivatives, especially the risk of losing whole capital, which could result from even marginal changes in underlying assets' prices. This *ratio legis* – protecting clients from the loss also affects the interpretation.

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Considering the circumstances mentioned above, it is important to stress that the legislator in Article 73 paragraph 2a of the Act on Trading, clearly distinguishes between requirement of holding a margin and execution of orders on behalf of clients. Moreover, regulation considers specific nature of derivative trading in terms of execution of orders. Hence the requirement of holding a margin and provision "*investment firm executes orders to buy or sell financial instruments, mentioned in Article 2 paragraph 1 point 2(c-i) placed by individual client*" must be considered in three situations, when individual client places order to:

a) buy financial instrument;
b) sell financial instrument;
c) buy and sell financial instrument, if, according to regulations, sequence of client's orders is specific for given financial instrument and investment firm offers such services.

Considering situation in point c) is the consequence of common investors' behaviours being reflected in regulations with regard to derivative trading. In order to mitigate risk when keeping open derivative positions, investors often place orders to close their positions if prices change in a certain way (e.g. "stop loss" and "take profit" orders). Placing opposite orders for the same financial instrument is also common.

Possible scenarios listed above, as well as the aim to mitigate risk are reflected in margin requirement. The requirement of holding a margin for given financial instrument, which is not less than 1% of the nominal value of that financial instrument applies to all situations listed above (a-c).

With that in regard, Department indicates:

Ad a) Investment firm executes buy order for financial instruments mentioned in Article 2 paragraph 1 point 2(c-i) of the Act on Trading – margin required from individual clients is not less than 1% of the nominal value of financial instrument.

Ad b) Investment firm executes sell order for financial instruments mentioned in Article 2 paragraph 1 point 2(c-i) of the Act on Trading – margin required from individual clients is not less than 1% of the nominal value of financial instrument.

Ad c) Investment firm executes buy (sell) order for financial instruments mentioned in Article 2 paragraph 1 point 2(c-i) of the Act on Trading and then takes order to sell (buy) the same financial instrument.

There are two variants of the last situation:

1) Investment firm takes buy (sell) order and at the same time takes order to sell (buy) the same financial instrument with specific instructions from the client regarding price changes – in order to minimise losses (stop loss order) or to lock in profits (take profit order).
2) Investment firm executes buy (sell) order and later takes order to sell (buy) the same financial instrument with specific instructions from the client regarding price changes – in order to minimise losses or to lock in profits.

Executing order of the same amount in the opposite direction effectively closes position and eliminates margin requirement (imposed when the first order was placed). It is therefore not

necessary to provide additional margin of no less than 1% of the nominal value of financial instrument for the second order of the same amount but opposite direction to the first order.

Neither of the variants mentioned above (1 and 2) requires margin for the second order closing the position, unless value of the second order is greater than value of position created by the first order. If value of the second order is greater than value of position created by the first order, then required margin is calculated from the result of the subtraction of value of position created by the first order from value of the second order. In that case, position created by the first order is closed and another position, this time of opposite direction is opened.

3) Investment firm executes one or more client's orders to buy financial instrument mentioned in Article 2 paragraph 1 point 2(c-i) of the Act on Trading. Later, client places opposite order for the same financial instrument, which however doesn't close position created by the earlier orders.

In this situation, where individual client mitigates risk by placing opposite orders, requirement of holding a margin of no less than 1% of the nominal value of financial instrument should be interpreted as a requirement of holding a margin of no less than 1% of the nominal value of financial instrument calculated from the order of the higher value.

Yours faithfully,