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# **Guidelines**

for providing brokerage services on the OTC derivatives market

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Warsaw, 2016

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## Introduction

Over the past decade, the capital market has witnessed significant transformations. Venues of capital transfer, which were previously used by participants of the capital market, were mainly concentrated around activity on regulated markets and equity or debt financial instruments listed there. Failures to achieve satisfactory, anticipated by investors, rates of return on such traditional investments naturally resulted in a surge in the popularity of such areas of the capital market which could bring them relatively appropriate, higher profit. One of these areas was the so-called over-the-counter market (OTC market) on which investment firms started offering the possibility to enter into transactions in leveraged financial instruments, including primarily contracts for difference and options. Given the financial leverage effect applied and lack of parameter standardisation, the specific nature of these derivatives determines specific conditions for any reasonable investment activity. The first and foremost requirement is to have extensive investment knowledge or experience which would make it possible to fully understand how such financial instruments work. Furthermore, unlike securities, OTC derivatives have a built-in financial leverage mechanism, thus necessitating that additional financial liabilities related to an open position be incurred. Therefore, derivatives require constant monitoring of market situation, of their valuation and prices of underlying instruments which becomes crucial particularly as regards the level of loss incurred. Minutes or even seconds often play a key role in this regard. Thus, delaying the execution of investment e.g. until the next day, or intention to withstand an unfavourable trend, exposes an investor to significantly higher risk and additional cost as a result of e.g. fees charged by investment firms for maintaining positions. Together with the observed instability of financial markets or the occurrence of turmoil in other areas of the economy (often resulting from geopolitical issues) and the use of high financial leverage, this may lead to generating extreme losses which often exceed funds entrusted to an investment firm. In case of a retail client, such a situation may also cause, on top of significant financial damage, long-term or irrevocable distrust in the capital market and aversion to investing there.

Given such phenomena, not denying the legitimate possibility of investing in leveraged derivatives, the role of a supervisory authority is to undertake actions which might contribute to relevant perception of investments in OTC derivatives.

In pursuing this mission, basic risk factors were pointed out and results of a study conducted among domestic investment firms offering their clients the opportunity to invest in OTC derivatives through online transaction platforms, which reveal a consistently high share of loss-making clients, were made public<sup>1</sup>.

Notwithstanding information projects targeting investors and regarding risks and rewards of investments in OTC derivatives, actions addressed to professional providers of brokerage services to these investors are undertaken as well. The PFSA Office's statements to date, which were formulated based on supervisory experience, were intended to indicate good and poor practices in the conduct of investment firms and explain how to understand selected laws, in light of the specific nature of investments in OTC derivatives<sup>2</sup>.

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<sup>1</sup> [https://www.knf.gov.pl/Images/KNF\\_CFDs\\_22-06-11\\_tcm75-26793.pdf](https://www.knf.gov.pl/Images/KNF_CFDs_22-06-11_tcm75-26793.pdf);  
[https://www.knf.gov.pl/Images/instrumenty\\_na\\_rynku\\_forex\\_tcm75-29721.pdf](https://www.knf.gov.pl/Images/instrumenty_na_rynku_forex_tcm75-29721.pdf);  
[http://www.knf.gov.pl/Images/KNF\\_forex\\_18\\_04\\_2012\\_tcm75-30319.pdf](http://www.knf.gov.pl/Images/KNF_forex_18_04_2012_tcm75-30319.pdf);  
[https://www.knf.gov.pl/Images/KNF\\_forex\\_2\\_07\\_2013\\_tcm75-35006.pdf](https://www.knf.gov.pl/Images/KNF_forex_2_07_2013_tcm75-35006.pdf);  
[https://www.knf.gov.pl/Images/KNF\\_forex\\_8\\_10\\_2014\\_tcm75-39268.pdf](https://www.knf.gov.pl/Images/KNF_forex_8_10_2014_tcm75-39268.pdf).

<sup>2</sup> The PFSA Office's Statement of 17 July 2013 on the conduct of investment firms on the forex market;  
[http://www.knf.gov.pl/Images/stanowisko\\_Forex\\_tcm75-35192.pdf](http://www.knf.gov.pl/Images/stanowisko_Forex_tcm75-35192.pdf)

The PFSA Office's Statement of 21 July 2015 on the required level of the margin for a financial instrument:  
[http://www.knf.gov.pl/Images/stanowisko\\_KNF\\_DEPOZYT\\_ZABEZPIECZAJ%C4%84CY\\_PL\\_tcm75-42358.pdf](http://www.knf.gov.pl/Images/stanowisko_KNF_DEPOZYT_ZABEZPIECZAJ%C4%84CY_PL_tcm75-42358.pdf)

Given that extremely highly leveraged contracts for difference (the PFSA Office identified instances where leverage exceeded 1:500) were introduced on the Polish market, systemic intervention with respect to retail clients became justified. The PFSA Office promoted legislative measures designed to introduce a statutory minimum level of the margin, when executing clients' orders, for derivatives not cleared by an authorised central clearing counterparty (CCP), as a result of which the Act on trading was amended<sup>3</sup>. Although the amendments introduced are not in line with the value of the minimum margin promoted by the PFSA Office, following other countries (U.S., Japan, Canada), i.e. 2% of nominal transaction value (compared to 1% of value after the amendment), the mere fact of eliminating extremely highly leveraged derivatives is the right action to be taken, given the escalation of leverage value.

The PFSA Office takes note that investment firms are constantly willing to develop brokerage services for retail clients on the OTC derivatives market and acquiring clients for this market. For this purpose, investment firms, *inter alia*, develop their ICT infrastructure, access applications, conclude contracts with third parties at home and abroad as counterparties, engage non-capital market entrepreneurs in advertising and promotional actions, extend their offer of financial instruments and types of brokerage services, as well as the way they are provided, to clients on the OTC derivatives market.

The PFSA Office's recent monitoring of such actions of investment firms in the form of both ongoing analytical supervision and inspections of investment firms resulted in further observations. Some of them indicate the presence of signs of misconduct in providing brokerage services to a client.

Summing up supervisory experience from previous years, which remains relevant, and considering the findings on new circumstances related to providing brokerage services on the OTC derivatives market, the Polish Financial Supervision Authority, whose objectives in relation to the financial market were set out in Article 2 and Article 4(1) (2) of the Act of 21 July 2006 on financial market supervision (Journal of Laws of 2016, items 174 and 615), decided to issue "Guidelines for providing brokerage services on the OTC derivatives market".

The purpose of the Guidelines is to set forth the manner of implementing laws with regard to the key aspects of providing brokerage services on the OTC derivatives market by investment firms to clients. As investments on the OTC market may take different forms, the Guidelines address both a situation, in which clients place their orders in person and also in a situation, in which an investment firm, while managing a client's portfolio including one or more financial instruments, and placing orders for the benefit of that client, executes a previously taken independent investment decision in relation to assets belonging to the client.

Given that the Guidelines are a set of legal interpretations, relevant laws, which are the main source of obligations of investment firms, were indicated when clarifying the content of each Guideline. The Polish Financial Supervision Authority is convinced that this is another step which will serve to ensure acting in accordance with a client's best interests and which will ensure further enhancing the client's protection in his/her business with an investment firm.

As a matter of fact, the Polish Financial Supervision Authority takes note that Polish law (implementing the Markets in Financial Instruments Directive) provides retail clients with particular protection due to a possible disparity in their knowledge and experience compared to investment firms which provide services to them. However, investment firms are institutions which specifically found their relationship with a client on his/her trust in their

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<sup>3</sup> The Act of 5 December 2014 amending the Act on trading in financial instruments and certain other acts (Journal of Laws of 2015, item 73)

professionalism and commitment to act in accordance with his/her best interests. The Authority points out that the use of that wording by the Polish legislator, pursuant to Article 19(1) of the MiFID, emphasised the absolute commitment of an investment firm to act in a honest, fair and professional manner. This means that the investment firm should exercise the highest diligence that may be expected from a professional entity and that the obligation to act in accordance with its client's best interests shall be an inherent element of any brokerage activity from a catalogue of services provided by the investment firm to its clients. This is particularly important if a retail client places orders through the investment firm to enter into transactions in financial instruments of high investment risk.

Obligations of investment firms in this area are primarily laid down in the following laws:

- Article 73(2a)-(2c) and (5a)-(5h), Article 75(1), Article 79(1)-(6a), Article 82(3a) (2) and Article 82(3a) (3), Article 83(1) (2) and Article 83a(1)-(3) of the Act on trading;
- § 8-9, § 10(1)-(2), § 11-12, § 13(1)-(2), § 15-16, § 19, § 21, § 23(1)-(5), § 24(1), § 24(13), § 24(14) (2)-(3) and § 24(14) (5), § 27-28(7), § 47(1), § 48, § 52 and § 53 of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms, banks, which are referred to in Article 70(2) of the Act on trading in financial instruments, and custodian banks (Journal of Laws of 2015, item 878);
- § 3(1)-(5), § 4-5, § 7, § 8(1), § 9(1)-(2), § 13(1), § 14(1), § 14(5) and § 14(12)-(13) as well as § 15(2) and § 15(5) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions for investment firms, banks, which are referred to in Article 70(2) of the Act on trading in financial instruments, and custodian banks and the conditions of assessing internal capital by brokerage houses (Journal of Laws of 2012, item 1072).

The Polish Financial Supervision Authority would like to stress that, although – given the objectives of these Guidelines – they are directly addressed to investment firms providing brokerage services on the OTC derivatives market, the manner of implementing laws governing the conduct of brokerage activity described herein is universal and should be adequately applied also by investment firms which offer their services related to financial instruments other than OTC derivatives on or outside a regulated market. In fact, these Guidelines cover important aspects related to providing brokerage services by an investment firm, regardless the type of the market and financial instruments. These aspects include: acquiring clients, advertising and promoting brokerage services, concluding contracts for providing brokerage services, discharging information obligations towards a client or a prospective client. The Guidelines dedicated to providing services of managing portfolios, which include one or more financial instruments, should be taken into account by investment firms providing such services outside the OTC derivatives market, as regards particularly: the way investment strategies are formulated and presented to the client, employment of investment advisors and monitoring of the provision of these services.

Please note that certain provisions of the Guidelines were directly determined by the OTC derivatives market's endemicity, in particular the specific nature of this kind of financial instruments and the way brokerage services are provided to clients. Distinguishing features include the fact that most transactions are entered into by a client directly through an investment firm and that a financial instrument is relatively highly leveraged and the level of financial leverage is determined independently. For these reasons, Guideline No. 9 will not apply to executing clients' orders on a regulated market or in a multilateral trading facility.

The Polish Financial Supervision Authority notes that the Guidelines contain useful information on how an investment firm can properly discharge its obligations as part of its

current brokerage activity. This document should be analysed, and information contained herein should be referred to conducted activity, by a Supervision Inspector, regardless of whether and in what area the investment firm provides brokerage services.

Moreover, with regard to Article 73(2d) of the Act on trading, the Polish Financial Supervision Authority indicates that the exclusion contained in that provision applies only to a certain section of Guideline No. 7 (i.e. the one on recommending to charge the margin, taking into account its minimum value specified by law) as regards Polish investment firms which conduct brokerage activity outside the territory of the Republic of Poland through a branch or without establishing a branch.

The above means that the indicated supervised entities shall apply other Guidelines in the same way as Polish law is binding upon national entities when conducting brokerage activity outside the territory of the Republic of Poland, i.e.:

- a) in the case of conducting brokerage activity without establishing a branch – in full scope,
- b) in the case of conducting brokerage activity through a branch – to the extent that branch is subject to Polish regulations.

With regard to foreign investment firms authorised to conduct brokerage activity in the territory of the Republic of Polish, the Guidelines will apply to the extent that a legal basis for their formulation refers to Polish law applicable to their activity. At the same time, bearing in mind that the Guidelines serve to enhance retail clients' protection, the Authority is convinced that, as this goal is universal, it is possible, when conducting brokerage activity in the territory of the Republic of Poland by authorised foreign investment firms, to take into account their content also to the extent that Polish law will have no direct application. For these reasons, the Authority recommends that the Guidelines be comprehensively analysed and, where legal regulations of a home country make it possible, their content be taken into account in brokerage activity conducted in the territory of the Republic of Poland.

These Guidelines shall also apply to the banks referred to in Article 70(2) of the Act on trading (providing services under powers conferred upon them by the Act – Banking Law). Obligations in this area are primarily laid down in the following laws applied by these banks based on the reference in Article 70(4) of the Act on trading:

- Article 73(2a)-(2c), Article 75(1), Article 79(1)-(6a) and Article 83a(1)-(3) of the Act on trading;
- § 8-9, § 10(1)-(2), § 11-12, § 13(1)-(2), § 15-16, § 19, § 21, § 23(1)-(5), § 24(1), § 24(13), § 24(14) (2)-(3) and § 24(14) (5), § 27-28(7), § 47(1), § 48, § 52 and § 53 of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms, banks, which are referred to in Article 70(2) of the Act on trading in financial instruments, and custodian banks (Journal of Laws of 2015, item 878);
- § 3(1)-(5), § 4-5, § 7, § 8(1), § 9(1)-(2) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions for investment firms, banks, which are referred to in Article 70(2) of the Act on trading in financial instruments, and custodian banks and the conditions of assessing internal capital by brokerage houses (Journal of Laws of 2012, item 1072).

In subsequent parts, the Guidelines use the collective term "investment firm" to refer also to the banks as referred to in Article 70(2) of the Act on trading (providing services under powers conferred upon them by the Act – Banking Law). Nevertheless, two circumstances related to the extent that these Guidelines are applied by financial institutions of this category should be indicated.

As regards transactions in OTC derivatives, which do not use the financial leverage mechanism and, at the same time, hedge exposures arising out of spot commercial contracts concluded as part of economic activity pursued by retail clients, Guidelines Nos. 7-9 shall not apply to the banks referred to in Article 70(2) of the Act on trading due to the nature of a transaction and a financial instrument.

However, please note that the aim of these Guidelines is to protect and duly secure a retail client's interests, thus meaning that the banks referred to in Article 70(2) of the Act on trading should, prior to entering into and during a transaction, verify, based on objective, current and reliable information, whether the transaction indeed serves that purpose. If not, the indicated financial institutions should apply Guidelines Nos. 7-9 when the retail client intends to enter into or maintain the transaction.

Furthermore, as the reference set out in Article 70(4) of the Act on trading does not require that the banks referred to in Article 70(2) of the Act on trading (providing services under powers conferred upon them by the Act – Banking Law) employ investment advisors, the content of Guidelines Nos. 15-16 should be referred by entities of this category to duties of persons having appropriate knowledge, skills and qualifications (cf. § 9(2) (1) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions).

The supervisory authority expects that the standards set forth in the Guidelines will be implemented by entities, to which they are addressed, no later than 30 September 2016.

Information on the application of the Guidelines should be forwarded by means of a form drafted by the supervisory authority to be completed by investment firms as part of their own assessment of compliance with the Guidelines. The form will be one of the supervisory authority's means of verification of compliance with the requirements set out in the Guidelines. The Guidelines shall be without prejudice to rights and obligations under law.

## Glossary of terms

**MIFID** – 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/EEC 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 of 30 April 2004, pp. 1-44, Polish special edition: Chapter 06, Volume 07, pp. 263-306; as amended);

**Act on trading** – the Polish Act of 29 July 2005 on trading in financial instruments (Journal of Laws of 2014, item 94 as amended);

**Act – Banking Law** – the Polish Act of 29 August 1997 – Banking Law (Journal of Laws of 2015, item 128 as amended);

**Code of Commercial Partnerships and Companies** – the Polish Act of 15 September 2000 – Code of Commercial Partnerships and Companies (Journal of Laws of 2013, item 1030 as amended);

**investment firm** – a brokerage house, a bank conducting brokerage activity, a foreign investment firm conducting brokerage activity in the territory of the Republic of Poland through a branch (in the designated scope), the bank referred to in Article 70(2) of the Act on trading (providing services<sup>4</sup> under powers conferred upon it by the Act – Banking Law);

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<sup>4</sup> The term "brokerage services" shall be understood as defined in these Guidelines.

**derivative** – the financial instrument referred to in Article 2(1) (2) (c)-(d) and (f)-(i) of the Act on trading;

**client** – the client referred to in Article 3(39c) of the Act on trading;

**Authority** – the Polish Financial Supervision Authority;

**organised trading** – the trading referred to in Article 3(9) of the Act on trading or trading conducted on a foreign regulated market or in a foreign multilateral trading facility;

**Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms** – the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms, banks, which are referred to in Article 70(2) of the Act on trading in financial instruments, and custodian banks (Journal of Laws of 2015, item 878 as amended);

**Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions** – the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions for investment firms, banks, which are referred to in Article 70(2) of the Act on trading in financial instruments, and custodian banks and the conditions of assessing internal capital by brokerage houses (Journal of Laws of 2012, item 1072);

**OTC derivatives market** – an over-the-counter area of the capital market where transactions in derivatives, in particular contracts for difference and in options, are entered into, primarily through online transaction platforms;

**PFSA Office** – the Polish Financial Supervision Authority Office;

**brokerage services** – the services referred to in Article 69(2) and (4) of the Act on trading and services provided to the client by a bank pursuant to Article 70(2) of the Act on trading (under powers conferred upon it by the Act – Banking Law);

**portfolio management services** – the brokerage services referred to in Article 69(2) (4) of the Act on trading;

**Guidelines** – the Guidelines for providing brokerage services on the OTC derivatives market.

## List of the Guidelines

### *Role of the investment firm's governing bodies in organising brokerage services on the OTC derivatives market*

#### **Guideline 1**

*As part of exercising its competences and powers laid down by law, the Supervisory Board of the investment firm should supervise the performance of brokerage activity with regard to the OTC derivatives market, while the Management Board of the investment firm should ensure that the areas referred to above be managed in compliance with law and the purpose of acting in accordance with the client's best interests.*

### *Acquiring clients and concluding contracts for providing brokerage services on the OTC derivatives market with clients*

#### **Guideline 2**

*The investment firm shall conduct its advertising and promotional actions as well as information actions related to acquiring clients to perform brokerage services on the OTC*



*derivatives market, always taking into account the client's or a prospective client's best interests.*

### **Guideline 3**

*The investment firm shall competently and fairly supervise third parties as regards the way of acquiring prospective clients by the third parties on behalf of the investment firm to whom brokerage services on the OTC derivatives market will be provided.*

### **Guideline 4**

*The investment firm shall exercise due diligence to ensure that the client or a prospective client, prior to concluding a contract for providing brokerage services on the OTC derivatives market, be given the opportunity to carefully read reliable, complete and not misleading information on these services, financial instruments concerned and investment risk.*

### **Guideline 5**

*The investment firm shall regularly train its employees who and the third parties referred to in Guideline 3 which acquire clients or prospective clients so as to acquire sound knowledge of brokerage services provided on the OTC derivatives market and/or financial instruments concerned.*

### **Guideline 6**

*The investment firm shall carry out a reliable assessment of suitability of brokerage services provided on the OTC derivatives market and of financial instruments, shall notify prospective clients of its results and exercise due diligence to ensure that prospective clients consent to conducting such an assessment.*

## ***Selected issues pertaining to contracts for providing brokerage services on the OTC derivatives market***

### **Guideline 7**

*In pursuing the requirement to act in accordance with the client's best interests, the investment firm should construct its product offers for retail clients so that investing in OTC derivatives be of quality similar to investments on the capital market, related to real market conditions, by determining an adequate level of the margin and recommending that the client holds a higher margin than a minimum required.*

### **Guideline 8**

*The investment firm which provides the brokerage services, as referred to in Article 69(2) (2) of the Act on trading, on the OTC derivatives market to the client should, as part of its order execution policy, notify the client of a standard timeframe for executing a derivative purchase or sale order, following its registration in the investment firm's IT system, under standard market conditions.*

### **Guideline 9**

*In pursuing the requirement to provide detailed information on the service provided and investment risk related to financial instruments, the investment firm, which executes clients' orders and keeps relevant records of derivatives and cash accounts for the clients, should provide the clients with data on results achieved by the clients on the OTC derivatives market and regularly publish it on its website to enable them to make informed investment decisions.*

### **Guideline 10**

*In a contract for providing brokerage services on the OTC derivatives market and in regulations for providing brokerage services on the OTC derivatives market, the investment firm shall use terminology consistent with law, primarily as regards identifying the type of services and financial instruments which are covered by the contract. In defining types of financial instruments, which are covered by a specific brokerage service, the investment firm may also use terminology commonly used in trading on the OTC derivatives market, primarily the one provided for in general terms and conditions of the contract, specified by organisations which bring together participants of the market.*

#### **Guideline 11**

*In a contract for providing brokerage services on the OTC derivative market, the investment firm shall include reliable, accurate and complete information on fees, commissions and other costs incurred by clients or cash benefits received by the investment firm from clients or third parties with regard to the contract with the client and its implementation.*

#### **Guideline 12**

*In a reliable, accurate and not misleading manner, the investment firm shall establish rights and obligations of parties to a contract for providing brokerage services on the OTC derivatives market and shall set out the mode and conditions of their provision.*

### ***Provision of brokerage services of managing portfolios which include one or more financial instruments from the OTC derivatives market***

#### **Guideline 13**

*The investment firm shall develop and apply investment strategies which include reliable, clear and not misleading information on: portfolio composition, investment limits, an objective financial index to which results of the client's portfolio with a specified investment strategy will be compared and principles for using the client's funds in connection with managing the portfolio which includes one or more financial instruments on the OTC derivatives market.*

#### **Guideline 14**

*The investment firm shall apply technical, organisational and legal solutions which ensure prevention of conflicts of interests, equal treatment of clients and acting in accordance with the client's best interests when providing brokerage services of managing a portfolio which includes one or more financial instruments on the OTC derivatives market.*

#### **Guideline 15**

*To provide brokerage services of managing a portfolio, which includes one or more financial instruments on the OTC derivatives market, the investment firm shall ensure that licensed investment advisors, who have knowledge of and experience in the OTC derivatives market, constantly and actively participate in making and implementing investment decisions on purchasing and selling financial instruments to clients' portfolios.*

#### **Guideline 16**

*The investment firm shall ensure that activities related to providing brokerage services of managing a portfolio, which includes one or more financial instruments on the OTC derivatives market, be systematically and effectively supervised.*

## List of the Guidelines with explanations

### *Role of the investment firm's governing bodies in organising brokerage services on the OTC derivatives market*

#### **Guideline 1**

*As part of exercising its competences and powers laid down by law, the Supervisory Board of the investment firm should supervise the performance of brokerage activity with regard to the OTC derivatives market, while the Management Board of the investment firm should ensure that the areas referred to above be managed in compliance with law and the purpose of acting in accordance with the client's best interests.*

Main legal basis: Article 201, Article 219(1) of the Code of Commercial Partnerships and Companies, Article 368(1) and Article 382(1) of the Code of Commercial Partnerships and Companies and § 13(1), § 14(1), § 14(12)-(13), § 15(2) and (5) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions.

1. As regards the OTC derivatives market, the Supervisory and Management Board of the investment firm should pay particular attention to:
  - the method of conducting advertising and promotional actions as well as information actions related to acquiring clients by the investment firm,
  - the *modus operandi* of third parties with which the investment firm cooperates in acquiring clients,
  - the method of assessing the suitability of a financial instrument or brokerage services,
  - an adequate level of the so-called financial leverage required for a given financial instrument in connection with the nature of an underlying instrument and the category of the client,
  - clarity and transparency of principles for providing a brokerage service offered based on a contractual relation with a retail client,
  - technical and organisational conditions for providing brokerage services on the OTC derivatives market,
  - identification and mitigation of risk likely to harm the client's best interests in connection with the provision of brokerage services of managing a portfolio which includes one or more financial instruments on the OTC derivatives market,
  - margin calculation principles.
2. The Supervisory and Management Board shall act within their statutory competences and powers.
3. In constantly supervising the activity of the company in all areas of its operations, the Supervisory Board should ensure that internal regulations, which were developed and implemented for application in the investment firm, require the Management Board to systematically prepare relevant information on the way of providing brokerage services on the OTC derivatives market, including those referred to in paragraph 1, and present it to the Supervisory Board.

4. The Management Board of the investment firm shall ensure that internal procedures allow for, *inter alia*:
  - verifying, at least once a year, regulations for providing brokerage services on the OTC derivatives market and contracts concluded with both clients and other entities to provide these services by using a system for supervising the legality of activity,
  - systematically controlling the compliance of the investment firm's activity with internal regulations as well as receiving and handling complaints of clients related to the provision of brokerage services on the OTC derivatives market by using an internal control system,
  - performing, at least once a year, internal audits of the functioning of the system for supervising the legality of activity and the internal control system in connection with the provision of brokerage services on the OTC derivatives market.
5. The Supervisory Board should regularly become familiar with results of the functioning of internal systems to verify whether the Management Board of the investment firm effectively supervises and controls the provision of brokerage services on the OTC derivatives market.
6. The Supervisory and Management Board should also ensure effective internal communication as regards the provision of brokerage services on the OTC derivatives market and that supervisory actions comply with the investment firm's objectives and needs. To this end, the Supervisory and Management Board of the investment firm should:
  - analyse whether it is justified to appoint or designate (in accordance with the principle of proportionality) an officer of the investment firm or a team responsible for providing brokerage services on the OTC derivatives market,
  - ensure that the analysis referred to above takes into account the specific nature of the OTC derivatives market, exposure to risk posed by the brokerage services provided as well as the scale and specific nature of these services.

The team's work should be coordinated by an appropriately qualified member of the Management Board of the investment firm or an officer designated by the Management Board of the investment firm. A business model for conducting activity in the field of providing brokerage services on the OTC derivatives market should be approved by the Management Board of the investment firm once it is presented to the Supervisory Board.

7. As regards a bank conducting brokerage activity, responsibilities assigned to the Management Board in the Guideline shall be discharged jointly by a manager of a separate bank unit, in which brokerage activity is performed, and a member of the Management Board of the bank who supervises that brokerage activity.

### ***Acquiring clients and concluding contracts for providing brokerage services on the OTC derivatives market with clients***

#### **Guideline 2**

*The investment firm shall conduct its advertising and promotional actions as well as information actions related to acquiring clients to perform brokerage services on the OTC derivatives market, while taking into account the client's or a prospective client's best interests.*

Main legal basis: Article 83a(2) of the Act on trading, § 8(1), § 9, § 13 and § 23(1)-(5) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of

conduct of investment firms and § 3(1)-(5) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions.

1. In connection with the continuing interest of retail clients in the OTC derivatives market, investment firms shall undertake concerted actions to acquire clients in Poland and abroad and to effectively conclude contracts for providing brokerage services with these clients. For advertising and promotional purposes, investment firms shall use available communication channels, including primarily popular social networking sites, information sites or economic and financial sites.

These actions should be considered as inherent in the investment firm's brokerage activity. This means that both promotional activity, which is aimed at concluding a contract with the client, and information (advertising) activity, are subject to regulatory restrictions to the same extent.

2. To ensure that advertising and promotional actions as well as information actions take into account the client's or a prospective client's best interests, the investment firm should:
  - when selecting methods used to encourage clients or prospective clients to invest on the OTC derivatives market, consider the fact that such persons have very diverse and often negligible knowledge of and experience in the capital market, including primarily the OTC derivatives market,
  - consider the above circumstances, mainly with regard to the method of formulating advertising and promotional information and messages targeting an unspecified recipient, so that the language used in advertising and promotional communications is appropriate for the level of the client or a prospective client who may not know or understand terminology related to investing on the OTC derivatives market. If so, such a person focuses solely on terms the importance of which is clear to him/her, ignoring references to essential terms and conditions of providing brokerage services on this market the importance of which eludes him/her e.g. the fact that even several seconds may be significant from the perspective of value of the client's liabilities under open positions. The language of communications used by the investment firm should guarantee that a message is understandable for each prospective client which is especially important when addressing advertising and promotional information to an unspecified recipient,
  - in undertaken advertising and promotional actions, avoid introducing benefits to encourage clients or prospective clients to invest more on the OTC derivatives market or to undertake additional, riskier investment actions on this market if obtaining a specific benefit becomes an objective *per se* or a driver for the client's increased investment activity, including in terms of the amount of the funds involved. Therefore, this type of practice should include offering clients or prospective clients any attractive, valuable but elusive cash or non-cash benefits (i.e. bonuses) by the investment firm, which are to be granted when the client reaches a given profit level in a specific period, often also correlated with the amount of funds deposited to a cash account or reaching an appropriate volume of transactions entered into by the client. A different qualification should therefore be applied when, as a result of exceeding certain quantitative criteria, the investment firm, as part of the policy established, collects reduced cash benefits (fees, commissions) from the client for provided services or grants non-cash benefits to facilitate investment activity (e.g. access to information sites or analytical studies). As a matter of fact, it is difficult in such a case to assume that the main objective of the client's investment activity is to meet criteria for obtaining a cash or non-cash benefit from the investment firm. Obtaining such

benefits is an additional, somewhat "incidental", effect of investment activity. It is also worth noting that granting virtual cash deposits by the investment firm to clients or prospective clients allows the possibility of higher leverage as compared to the level resulting from an "initial" deposit deposited by the client. Consequently, such conduct may constitute the investment firm's breach of Article 73(2a) and (2b) of the Act on trading or classifying these activities as the brokerage activity referred to in Article 69(4) (2) of the Act on trading,

- in undertaken advertising and promotional actions, meet a standard, which complies with terms and conditions of dealing with a retail client, ensuring that information addressed to a wide and unspecified range of recipients be complete and reliable. "Complete" and "reliable" should be understood as:
  - i. striking a balance between advertising slogans and content focused on positive aspects of investing on the OTC derivatives market and information on a complex nature of financial instruments which are covered by the transactions entered into and high investment risk,
  - ii. avoiding excessive emphasis (e.g. by font size, graphic layout, symbols) in advertising and promotional materials on information on profits obtainable through investment on the OTC derivatives market as compared to information on risk of investment losses (e.g. by generalising such information, including it in small print or in a subsequent part of a document, or even in a separate document),
  - iii. clarifying the key impact of the so-called financial leverage on both the possibility of high profits and high losses on funds invested by the client or a prospective client, making it clear that there is the possibility of loss exceeding the value of the funds and using practical examples of possible losses,
  - iv. eliminating any advertising and promotional slogans and content which may result in clients' or prospective clients' incorrect perception as to the nature of financial instruments or the method of providing brokerage services on the OTC derivatives market by the investment firm or as to investment risk related to derivatives covered by orders and transactions on this market,
  - v. making sure that investment results (usually positive) of natural persons, presented by investment firms in advertising for brokerage services on the OTC derivatives market, were results of real clients of the investment firm and that the presented financial result was representative of such a client in a sufficiently long reference period. Such information is particularly useful to ensure that an advertising and promotional message of the investment firm be reliable. Such information is also necessary to avoid misleading clients or prospective clients when the investment result on the OTC derivatives market presented by a given person is combined with a suggestion that such income level is permanent,
- avoid fixing remuneration of employees involved in client acquisition who, as part of their professional activities, undertake advertising and promotional actions as well as information actions in a manner generating a conflict of interests between employees' pursuit of remuneration and the obligation to act in accordance with the client's best interests, in particular avoid fixing remuneration dependent, either formally or actually, fully or mostly, on the amount of funds deposited by the client, the value or number of transactions entered into by an acquired client or on the client's profit earned or loss incurred. For example, when fixing the value of remuneration against

funds deposited by the acquired client on a cash account, the investment firm should be aware that this mechanism generates significant risk on the part of employees inclining the client or a prospective client to pay more than originally specified by this client or prospective client. This risk is even greater when the investment firm's profit (earned on its own or as a company operating within a capital group) is directly reflected in the client's loss.

In consequence, the investment firm should introduce effective and efficient solutions for mitigating such risk. This objective may be achieved through e.g. classification of clients by objective criteria (ranges) and paying of a predetermined amount for the acquisition of a client belonging to a specific category or paying fixed *per capita* remuneration. Another example of correct conduct of the investment firm is when remuneration of employees involved in client acquisition is based solely on qualitative criteria (e.g. indicators of quality of assistance to the client and the services provided) or quantitative and qualitative criteria. In the latter case (hybrid model), it should be noted that particular components of remuneration be given due consideration to eliminate situations when a quantitative criterion (e.g. the amount of funds deposited by the client, the value or number of transactions entered into by the client) remains the main determinant of employee's behaviour,

- avoid intensifying advertising and promotional actions as well as information actions with respect to a specific client, whose order to withdraw funds from a cash account has been received, which would be aimed actually at “buying time”, making it more difficult for the client to have his/her order executed or persuading the client to cancel the order. Examples of such actions include in particular the investment firm's activity which, due to frequency of client contacts or attempted contacts, is onerous to the client or, due to the content and formulation of a message – aggressive, which may significantly limit the client's freedom of choice. Undesirable actions of the investment firm should also be deemed to include actions which, through alleged advertising and promotional or information message, can be considered as an unacceptable form of investment recommendation intended to persuade the client to invest funds, which were to be withdrawn, in transactions on the OTC derivatives market. Contacting the client by the investment firm to present such a client with a promotional offer of fees, commissions or additional investment amenities, when an order to withdraw funds entails the client's resignation from investment firm's brokerage services, should not be considered as undesirable activity.

### **Guideline 3**

*The investment firm shall competently and fairly supervise third parties as regards the way of acquiring prospective clients by the third parties on behalf of the investment firm to whom brokerage services on the OTC derivatives market will be provided.*

Main legal basis: Article 83a(1)-(2) in conjunction with Article 82(3a) (2) of the Act on trading, Article 79(1)-(6a), § 8(1), § 9, § 13 and § 23(1)-(5) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms and § 3(1)-(5), § 4-5, § 7 and § 14(1) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions.

1. Given that advertising and promotional activity is a part of brokerage services, the investment firm shall supervise the content of advertising information, its presentation and use in direct contacts with the client or a prospective client, regardless of whether advertising activity is conducted directly by the investment firm or by third parties operating on behalf of or for the benefit of the investment firm concerned.

2. The investment firm, which uses services of a third party only as regards the use of a communication channel provided by this party to present advertising and promotional content (e.g. TV, radio, a portal or a website), shall ensure that the content be fair, reliable and not misleading for the client or a prospective client.
3. If a third party provides the investment firm with access to its website or a portal for promotional and advertising purposes, the investment firm should verify whether the third party does not use this information to encourage prospective clients of the investment firm to entrust such a third party with funds for management or whether it does not offer investment-advice typeservices to prospective clients. Such actions on the part of the third party put persons, who act on its behalf, at risk of a criminal sanction for conducting unauthorised brokerage activity. Using available sources of information, the investment firm should exercise due diligence to eliminate such reputational risk arising from cooperation with the third party.
4. If a third party actively acquires clients on behalf of the investment firm, that investment firm shall be responsible for both the content of promotional and advertising information and the way it is communicated by that party to clients or prospective clients of the investment firm. Active client acquisition should be understood as efforts to establish direct contact by the third party with prospective clients of the investment firm, including primarily: phone calls and personal meetings between the third party and prospective clients as well as sending emails to prospective clients of the investment firm.
5. In order to ensure that third parties, acting on behalf of or for the benefit of the investment firm, will perform or perform tasks entrusted to them with due care and in a manner ensuring sufficient protection of the client's or a prospective client's best interests, the investment firm should:
  - develop rules and standards regarding relations of third parties, performing contracted advertising and promotional activities, with the client or a prospective client,
  - ensure, by means of a relevant contract concluded with a third party, that the implementation of such a contract be supervised in an organised and regular manner so as to guarantee that the third party will not undertake, be it directly or indirectly, any investment – advice type actions or actions related to the client's account management,
  - within the adopted scope of cooperation between the investment firm and a third party, guarantee that the third party will not perform activities restricted for the investment firm or its agent in connection with providing brokerage services (e.g. receiving orders for the purchase or sale of financial instruments, investment advisory services) and monitor compliance with this obligation,
  - guarantee that remuneration of a third party under a contract concluded with the investment firm, provided that remuneration is permitted pursuant to brokerage activity provisions, will be presented to prospective clients or clients of the investment firm as required by these provisions and explanations of the PFSA Office<sup>5</sup>,
  - avoid fixing remuneration of third parties in a manner generating a conflict of interests between third parties' pursuit of remuneration and the investment firm's obligation to ensure that third parties will act in accordance with the client's best interests, in particular avoid fixing remuneration dependent, either fully or mostly, on the value of transactions entered into by an acquired client or on the client's profit earned or loss

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<sup>5</sup> The PFSA Office's Statement of 9 August 2011, ref. DFL/023/182/1/I/69/11/MK, ref. DFL/023/185/1/11/S/16/MK



incurred. When fixing the value of remuneration based on funds deposited by the acquired client to a cash account, the investment firm should be aware that this mechanism generates significant risk on the part of employees inclining the client or a prospective client to pay more than originally specified by this client or prospective client. In consequence, the investment firm should introduce effective and efficient solutions for mitigating this risk through e.g. classification of clients by objective criteria (ranges) and paying a predetermined amount for the acquisition of a client belonging to a specific category,

- avoid fixing third parties' remuneration dependent, either formally or actually, fully or mostly, on:
  - the amount of funds deposited by the client,
  - the value or number of transactions entered into by an acquired client or on the client's profit earned or loss incurred.

For example, when fixing the value of remuneration based on funds deposited by an acquired client to a cash account, the investment firm should be aware that this mechanism generates significant risk on the part of employees inclining the client or a prospective client to deposit more than originally specified by this client or prospective client. In consequence, the investment firm should introduce effective and efficient solutions for mitigating such risk. This objective may be achieved through e.g. classification of clients by objective criteria (ranges) and paying a predetermined amount for the client's belonging to a specific category or paying fixed *per capita* remuneration. Another example of correct conduct of the investment firm is when remuneration of third parties involved in client acquisition is based solely on qualitative criteria (e.g. indications of quality of assistance to a client and the services provided) or quantitative and qualitative criteria. In the latter case (hybrid model), it should be borne in mind that particular components of remuneration be given due consideration to eliminate situations when the quantitative criterion (e.g. the amount of funds deposited by the client, the value or number of transactions entered into by the client) remains the main determinant of third party behaviour.

- ensure that the content of a contract between the investment firm and the client clearly indicates that it is concluded by the client or a prospective client and the investment firm, and that the former should exclusively turn to the investment firm with regard to providing brokerage services for his/her benefit, rather than to a third party,
- subject third parties, as persons connected with the investment firm, to internal supervision. For this purpose, the investment firm should:
  - i. with respect to third parties who, as part of their contract concluded with the investment firm and activities pursued thereunder, may come to possess information subject to professional secrecy, oblige a third party, if need be, to comply with: internal regulations regarding the flow and protection of information subject to professional secrecy, principles for investing on own account, accepting and transferring cash and non-cash benefits received by the investment firm in connection with the provision of brokerage services and managing conflicts of interests,
  - ii. carry out internal controls on the fulfilment of obligations conferred upon a third party by internal regulations, compliance with which is mandatory for such a party,
  - iii. provide third parties with training in brokerage activity information, the mode and conditions of conduct with the client or a prospective client as well as

internal regulations of the investment firm, compliance with which is mandatory for such third parties, pertaining to the protection of professional secrecy and confidential information in connection with investments on own account by a third party. Such systemic actions minimise operational and legal risk related to this form of client acquisition,

- iv. verify the quality of activities performed by third parties, taking into account opinions of clients acquired by these parties, including filed complaints. This obligation also applies to investment firms for the benefit of which third parties conduct only promotional and advertising activity targeting prospective clients,
- systematically verify whether a third party properly, i.e. reliably and professionally, in accordance with fair trading principles and in accordance with the client's or a prospective client's best interests, discharges obligations arising out of a contract concluded with the investment firm. For this purpose, the investment firm should:
    - i. verify, by using publicly available sources of information on third parties (in the case of legal persons, organisational units without legal personality and natural persons as well), the scope or type of professional activity conducted by these parties prior to entering into cooperation with the investment firm, and whether such activity provided grounds for any legal action, including administrative action, against these parties (or their key personnel in the case of legal persons), e.g. sanctions imposed by a competent financial supervision authority, entry in a list of public warnings kept by such an authority,
    - ii. suggest that natural persons, who will conduct promotional and advertising activities, submit up-to-date certificates from relevant criminal records, etc.,
    - iii. verify whether natural persons, who will conduct promotional and advertising activities, or employees of third parties, who conduct promotional and advertising activities as described in paragraph 4, are getting powers of attorney for accounts of acquired clients and verify the scope and implementation of powers conferred upon them thereby. If such powers of attorney for accounts of the clients are granted, take actions to immediately explain reasons behind such a decision and, if doubts or irregularities occur, immediately take appropriate actions to protect the clients' (i.e. principals') interests,
    - iv. determine client acquisition methods used by third parties, communication channels, databases of prospective clients and *modi operandi* applied to garner interest of prospective clients in services of the investment firm offered on the OTC derivatives market, arguments used, including figures for possible profit and loss,
    - v. specify, in a contract with a third party, which will conduct promotional and advertising activities as described in paragraph 4, the method of effective and adequate verification of activities performed by that party, including through its employees (in case of third parties being legal persons).

#### **Guideline 4**

*The investment firm shall exercise due diligence to ensure that the client or a prospective client, prior to concluding a contract for providing brokerage services on the OTC derivatives market, be given the opportunity to carefully read reliable, complete and not misleading information on these services, financial instruments concerned and investment risk.*

Main legal basis: § 9(1)-(2), § 10(2) (7) in conjunction with § 10(1), § 10(2) (12), § 10(3), § 11 and § 13 of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms.

1. The investment firm shall communicate reliable, complete and not misleading information on brokerage services on the OTC derivatives market and financial instruments concerned, in particular by:
  - notifying clients of the specific nature of financial instruments offered as part of a brokerage service, with particular focus on distinguishing between a derivative, which the client or a prospective client may purchase or sell through the investment firm, and an underlying instrument, constituting only a basis for calculating the financial result from the purchased or sold derivative, whom the client neither purchases nor sells in transactions on the OTC derivatives market. The investment firm should provide clear information in this regard and make sure that the client or a prospective client knows of the type of financial instruments s/he invests in, e.g. as regards a contract for difference (derivative) based on share prices, that the investment applies to a derivative, rather than shares (equity instrument), being the underlying instrument,
  - presenting clients or prospective clients with detailed information on all aspects of investments in financial instruments concerned, such as e.g.:
    - i. detailed information explaining the essence of swap points which are applied by the investment firm. Such information may not be limited only to indicating values of swap points and general basis for their calculation. The information should indicate, *inter alia*, how the investment firm understands the essence of swap points, why and on what grounds they are applied and how they are calculated. The definition of swap points presented by the investment firm should, in a fair, complete and non-misleading manner, explain reasons for using swap points for derivatives concerned whose underlying instruments are various types of financial instruments (e.g. shares – denominated in PLN or a foreign currency) or currencies,
    - ii. detailed information on "roll-over" or equivalent terms. The investment firm should explain the term and its influence on the client's/a prospective client's open positions,
    - iii. detailed information on crediting long and charging short positions in contracts for difference, resulting from adjustments in the price of an underlying instrument, i.e. shares, by the amount of dividend deposited from them. The investment firm should provide the client or a prospective client with reliable, complete and not misleading information in this regard.
2. As online brokerage services develop dynamically, investment firms more and more often conclude contracts with clients away from their registered offices (remotely) or electronically. In both cases, the investment firm should ensure that the client or a prospective client reads all necessary information on the investment firm, terms and conditions of providing brokerage services on the OTC derivatives market, financial instruments concerned and investment risk.
3. The information obligation on the part of the investment firm shall be deemed to be fulfilled, provided that:
  - the client or a prospective client receives the information referred to above in a form which enables that client or prospective client to read and understand it,

- for that purpose, information should be outlined thematically, titled according to its content, collected in a single set of paper or electronic documents, provided with a table of contents or otherwise arranged,
- if this information is published on the investment firm's website, the client or a prospective client should get easy navigation to it, using clearly described tabs and hyperlinks, as well as the possibility of printing out such documents,
- the information referred to in this Guideline should be published on the website so as to direct the client's or a prospective client's attention to the need and importance of reading it prior to concluding a contract for providing services on the OTC derivatives market,
- the investment firm shall exercise due diligence to make the client actually read such information if the investment firm enables the client to conclude a contract remotely or electronically, in particular such information should be exposed so as to direct the client's or a prospective client's attention to the need and importance of reading it when concluding a contract for providing services on the OTC derivatives market. For example, the investment firm may provide its computer system with a solution which consists in presenting the client or a prospective client, when concluding the contract, with specific fields containing this information and receiving confirmation that such a client or prospective client have indeed read it. Furthermore, the investment firm shall ensure that an employee, who may be present when the client concludes the contract for providing brokerage services on the OTC derivatives market in electronic form, does not mark, on behalf of the client or a prospective client, relevant fields which confirm having read the documents in the investment firm's electronic system,
- financial instruments covered by brokerage services should be:
  - i. named in accordance with the terminology laid down in the Act on trading (to define financial instruments covered by a specific brokerage service, the investment firm may complementarily use terminology commonly used in OTC derivatives market trade practice),
  - ii. described in a manner neither raising any doubts nor misleading the client or a prospective client that purchase or sale orders do not cover underlying instruments (including currencies, shares, commodities, raw materials), but derivatives,
  - iii. described reliably with regard to the sources and nature of investment risk, including margin functions, the minimum margin and the so-called financial leverage.

## **Guideline 5**

*The investment firm shall regularly train its employees and the third parties referred to in Guideline 3 who acquire clients or prospective clients as allowing them to acquire sound knowledge of brokerage services provided on the OTC derivatives market and/or financial instruments concerned.*

Main legal basis: Article 82(3a) (2), Article 82(3a) (3) and Article 82(3a) (7) (a) in conjunction with Article 82(3a) (1) and (2) of the Act on trading, § 8(1), § 9(1) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms and § 9(2) (1) and (2) as well as § 14(5) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions.

1. Providing brokerage services on the OTC derivatives market by the investment firm requires delegating employees to contact the client or a prospective client. The employees shall possess sound knowledge of both this market and transactions in these instruments verified by the investment firm. As a matter of fact, such personnel are as important in discharging the information obligation towards clients or prospective clients as including this information in materials and electronic resources referred to in Guideline 4. Knowledge possessed by employees of the investment firm should particularly include: principles for purchasing and selling financial instruments on the OTC derivatives market, principles for establishing and maintaining the margin, using the so-called financial leverage, the type and characteristics of the adopted business model with regard to providing brokerage services on the OTC derivatives market, the type, calculation method and level of fees, commissions and other benefits collected from the client in connection with the provision of services.
2. The above information should be known and understood, for the purpose of communicating it to prospective clients, also by a third party which conducts advertising and promotional actions on behalf of the investment firm if that party actively acquires clients on behalf of the investment firm.
3. To ensure a proper standard and updating of knowledge of the provision of brokerage services on the OTC derivatives market by the investment firm, it should systematically:
  - train employees and third parties, which operate on its behalf, in the method of and principles for providing brokerage services on the OTC derivatives market if these parties actively acquire clients on behalf of the investment firm,
  - use, in such training, available information on reasons for client complaints to date related to this activity of the investment firm, statements of the PFSA Office, identified potential or real conflicts of interests to modify, as justifiably necessary, advertising and promotional activity by the investment firm or a third party on its behalf.

## **Guideline 6**

*The investment firm shall carry out a reliable assessment of suitability of brokerage services provided on the OTC derivatives market and of financial instruments, shall notify prospective clients of its results and exercise due diligence to ensure that prospective clients consent to conducting such an assessment.*

Main legal basis: Article 83a(3) of the Act on trading and § 8(1), § 15-19 and § 21 of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms.

1. Assessing the suitability of brokerage services on the OTC derivatives market and financial instruments concerned for the client or a prospective client is of key significance for determining whether this client or prospective client has sufficient knowledge and experience to invest in financial instruments characterised by high investment risk. The main purpose of this action is to ensure that the requirement to protect the client's best interests be met by determining whether and to what extent the client knows of and understands the risk related to investing on the OTC derivatives market. If the suitability of brokerage services for the client is assessed incorrectly, the investment firm fails to discharge the obligation to reliably notify the client of the risk that such a client takes in connection with having been provided with brokerage services.
2. To ensure that the suitability assessment is reliable and authoritative, i.e. enables the investment firm to objectively assess suitability, the investment firm should, in its

assessment procedure:

- include questions concerning knowledge of brokerage services covered by a contract with the client and financial instruments from the OTC derivatives market,
- exclude, as a rule, prospective client's self-assessment and rely on objective testing of investment knowledge and experience of the client with regard to brokerage services and financial instruments covered by a contract concluded by the client with the investment firm,
- use the client's self-assessment only in exceptional, justified cases when it is determined by the nature of information. In such a case, in order to verify the client's own judgment, it is advisable to ask additional questions which will allow the investment firm to sufficiently verify the client's opinion,
- adopt terminology used to determine the type of brokerage services or financial instruments so as to neither raise any doubts nor mislead the client or a prospective client, in particular due to its colloquialism or imprecise definition,
- if the suitability assessment is included in the course of concluding a contract with the client in electronic form, make sure that such a client or a prospective client answers questions on his/her own, i.e. without assistance or interference of the investment firm's employee,
- apply such principles for assessing the client's or a prospective client's answers which will reflect their actual importance for determining the client's level of knowledge of and experience in brokerage services provided on the OTC derivatives market and financial instruments. Therefore, the investment firm should avoid questions which do not directly relate to the subject matter of a contract concluded with the client or a prospective client, but which may affect the suitability assessment's final result,
- exercise due diligence to ensure that as many prospective clients as possible give consent to take part in the assessment. For this purpose, the investment firm should train its employees in presenting adequate argumentation and indicating the importance of conducting such an assessment to clients or prospective clients so as to provide proper protection and act in accordance with their best interests,
- notify the client or a prospective client, by using a durable medium, of consequences such a client or prospective client will face in case of refusing to answer questions as part of the assessment conducted, particularly the fact that such an approach prevents the investment firm from carrying out the assessment,
- ensure that, immediately after conducting the assessment, the investment firm notifies the client of its results, i.e. suitability or unsuitability with regard to brokerage services on the OTC derivatives market and financial instruments concerned. If there is no such information, the client may take a wrong decision with regard to concluding a contract. It is recommended that such information be drafted and its receipt be confirmed by the client in writing. If the assessment is conducted electronically, the information should be prepared on durable media and its receipt by the client should be registered by the investment firm, primarily by way of return receipt or a confirmation email from the client,
- ensure that, if unsuitability of a service or a financial instrument is declared and, at the same time, the client is still willing to conclude a contract, the client is once

again warned that entering into transactions entails risk of incurring substantial losses in case of unfavourable changes in the price of an underlying instrument.

***Selected issues pertaining to contracts for providing brokerage services on the OTC derivatives market***

**Guideline 7**

*In pursuing the requirement to act in accordance with the client's best interests, the investment firm should construct its product offers for retail clients so that investing in OTC derivatives be of quality similar to investments on the capital market, related to real market conditions, by determining an adequate level of the margin and recommending that the client holds a higher margin than a minimum required..*

Main legal basis: Article 73(2a)-(2c) and Article 83a(3) of the Act on trading and § 8(1) and § 24(1), § 24(13) and § 24(14) (2) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms.

In accordance with the Act on trading amended as of 16 July 2015 by way of adding Article 73(2a)-(2c), the investment firm shall execute a retail client's derivative purchase or sale orders, provided that the margin required for a specific financial instrument is no less than 1% of the nominal value of such a financial instrument. It should be assumed that the legislator's actions were dictated by offering retail clients on the OTC market derivatives with high, sometimes extreme (nominal and effective), financial leverage and the legitimacy of actions which, even if only to some extent, ensure the protection of their interests.

This is a statutory minimum with respect to a certain point in time in entering into transactions which may be understood as establishing, at the moment of opening positions, a threshold to limit the risk of a retail client (and the investment firm at the same time) in investing in certain derivatives, primarily contracts for difference. In accordance with law, the investment firm may collect a higher minimum margin and provide a retail client with other solutions to protect the client's interests.

It happens in market practice that a higher, progressive margin is collected from the client, especially when the client makes substantial investments in individual financial instruments or investments in financial instruments where an underlying instrument has relatively high volatility. Such a mechanism protects the investment firm against the risk of a settlement fail on the part of the client, but does not make it less possible that the client incurs substantial losses. Therefore, this operation does not symmetrically take into account interests of both parties to a contract for providing brokerage services. An impression of offering financial instruments with a margin level not correlated with the real risk is created particularly when the highest financial leverage is offered on the most popular OTC derivatives, with the lowest balance values on the client's investment account at the same time. As a matter of fact, this kind of practice of investment firms confirms absence of any resistance of the client's margin to even minimum volatility in instrument prices. Primarily as regards civil law disputes between the client and the investment firm, it may also be treated as conduct that goes against the general duty of the firm to act in accordance with the client's best interests.

It should also be pointed out that market practice knows situations when the investment firm sets the level of compulsory position closure (i.e. "stop-out" mechanism) significantly below the level of the so-called margin call. Given the level of the maximum effective financial leverage, such a situation also entails the risk of classifying the investment firm's conduct as contrary to the client's best interests in civil law disputes. This negative assessment may even deteriorate when the investment firm executes the client's order so that the client's loss as a result of investment is correlated with the investment firm's parallel profit.

Given the foregoing, in order to actually and fully implement the principle of acting in accordance with the client's best interest, the investment firm should:

- analyse market parameters of a given derivative (e.g. underlying instrument price volatility over a sufficiently long reference period, liquidity, appropriate time for unaided position closure, the risk of extraordinary market situations) and factors related to the nature of the client's investments (value of open positions or the amount of deposited funds by the client) and, if necessary to protect a retail client's interests, set and determine, based on a contractual relation with the client, an appropriate margin required to open a position, subject to the minimum margin set forth by the legislator,
- to set and determine, based on a contractual relation with the client, the level of compulsory position closure (i.e. "stop-out" mechanism), which is secure, consistent with the client's best interests, taking into account primarily the maximum effective financial leverage when the level of the "stop-out" mechanism was set below the level of the so-called margin call,
- draw the client's attention to the fact that opening a position for a given instrument may result in its immediate compulsory closure. The foregoing applies when immediate compulsory position closure is due to insufficient funds on the client's account (account balance including open positions, the so-called equity) solely as a result of transaction costs related to opening of this position. In particular, when the level of compulsory position closure (i.e. "stop-out" mechanism) is equal to the margin required, the investment firm shall recommend that the client has surplus funds on his/her account (equity) above the level of compulsory position closure by the so-called "stop-out" mechanism in consequence of transaction costs. The investment firm shall recommend that the client has surplus funds above the level of the "stop-out" mechanism so that the surplus funds bring resilience of the client's investment in a given instrument to its price volatility. In particular, the surplus funds should also protect the client against the compulsory closure of the client's position in a derivative as a result of a minimum, unfavourable for the client, change in prices of an underlying instrument,
- draw the client's attention to the fact that, when the level of compulsory position closure (i.e. "stop-out" mechanism) is set below the investment firm's minimum margin required to open a position, transaction costs may exceed the difference between the margin and the level of the "stop-out" mechanism which will result in immediate compulsory closure of such a position.

### **Guideline 8**

*The investment firm which provides the brokerage services, as referred to in Article 69(2) (2) of the Act on trading, on the OTC derivatives market to the client should, as part of its order execution policy, notify the client of a standard timeframe for executing a derivative purchase or sale order, following its registration in the investment firm's IT system, under standard market conditions.*

Main legal basis: Article 83a(3) of the Act on trading and § 8(1), § 10(1) and § 10(2) (7), § 47(1), § 48 and § 52-53 of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms.

The OTC derivatives market is a dynamic marketplace where numerous derivatives are quoted with various kinds of underlying instruments or of various components (e.g. a base



currency and a quoted currency). Characteristically, in the case of specific underlying instruments (base currency) constituting reference to quotation of derivatives, there is a possibility of extremely high liquidity. Additionally, adopted transaction conditions specify the minimum price tick with great accuracy – prices are quoted with accuracy from two to five decimal points. Lastly, the financial leverage mechanism used in derivative transactions makes the account balance of an average retail investor susceptible to even a minor price change.

In view of the above circumstances surrounding investments on the OTC derivatives market, a key factor for an investor becomes a timeframe for executing the client's order by the investment firm from the moment of receiving the order. Any delay, especially in the case of orders "at market price", may undermine client expectations in terms of future commitment, *inter alia*, further intention to enter into a transaction, a planned rate of return or the duration of holding a position. Therefore, it is fundamental that the client knows the timeframe for executing the order by the investment firm under typical, standard OTC derivatives market conditions and any departures from the specified order execution timeframe should be described in detail by the investment firm so that the client can easily and objectively verify whether a longer order execution timeframe than the standard one was justified.

In accordance with § 47(1) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms, the investment firm, which executes orders, shall undertake all reasonable measures to achieve the best possible result for the client, taking into account a price, costs, the duration of a transaction, the probability of entering into and settling that transaction, etc. Given this obligation, the investment firm should provide the client with sufficient information, which reflects all the main requirements, to ensure acting under the most favourable terms and conditions for the client (i.e. best execution formula) so that the client has sufficient information on order execution terms and conditions and thus can make an informed decision whether to use the investment firm's services.

Given the regulations above, the timeframe for executing the client's order is one of the main aspects to be considered by the investment firm when executing the client's orders and when seeking to achieve the best results for the client. In order to make an informed decision on the conclusion of a contract for executing orders on the OTC derivatives market, the client or a prospective client of the investment firm should know at least the standard timeframe for executing orders of clients by the investment firm. This is all the more important that the OTC derivatives market is decentralised and these are investment firms which create the client's liquidity (market).

The standard order execution timeframe may vary depending on:

- the type of a financial instrument,
- technical conditions of a transaction platform used by the investment firm,
- liquidity providers rendering services to the investment firm.

For these reasons, the investment firm, when providing the standard timeframe for executing the client's order and specifying situations in which this timeframe may be extended, enables the client to verify whether it executes orders with the aim of achieving the best results. This is particularly important when the investment firm executes the client's orders by entering into transactions directly with the client. In fact, it should also be noted in such a situation that the designated action is another tool for the proper management of a conflict of interests resulting from this way of entering into transactions. It should be noted that the Guideline does not require that the investment firm executes each order of the client within a specific timeframe. The requirement to present the standard order execution timeframe and to indicate a catalogue

of specific situations in which the execution timeframe may deviate from the standard one results from the investment firm's obligation to demonstrate to the client, at his/her request, that the firm acts in accordance with his/her best interests.

In order to implement the above Guideline, the investment firm should:

- determine, based on efficiency parameters of IT systems used and transactions to date, the standard timeframe for executing a derivative purchase or sale order, following its registration in the investment firm's IT system. The specified value should be given with the highest possible accuracy, including the capacity of IT systems used by the investment firm e.g. some transaction platforms allow to measure and present the order execution timeframe with the accuracy to one-thousandth of a second,
- introduce, as part of mandatory brokerage service information provided to the client or a prospective client prior to concluding a contract, information on the standard timeframe for executing a derivative purchase or sale order, following its registration in the investment firm's IT system, under standard market conditions,
- precisely and objectively define, as part of mandatory brokerage service information provided to the client or a prospective client prior to concluding a contract, a catalogue of specific situations in which the timeframe for executing the client's order by the investment firm may be extended,
- in case of exceeding the order execution timeframe, provide the client, at his/her request, with any necessary information enabling him/her to verify whether the investment firm operates properly.

### **Guideline 9**

*In pursuing the requirement to provide detailed information on the service provided and investment risk related to financial instruments, the investment firm, which executes clients' orders and keeps relevant records of derivatives and cash accounts for the clients, should provide the clients with data on results achieved by the clients on the OTC derivatives market and regularly publish it on its website to enable them to make informed investment decisions.*

Main legal basis: Article 83a(2) and (3) of the Act on trading and § 8(1), § 9(1) and § 13(1) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms.

The distinguishing element of investments in OTC derivatives is the use of the so-called financial leverage. Therefore, there is serious risk of incurring substantial financial losses by the client, even with a minor change in the price of an underlying instrument which is a basis for quoting prices of a given derivative.

It seems that a significant number of clients who, according to research, realise loss as a result of investment on the OTC derivatives market, are not fully aware of investment risk entailed by making investment decisions under submitted orders. Therefore, regardless of information presented so far by investment firms, related to the financial instrument concerned and describing the essence of the financial instrument and including a theoretical explanation of risk associated with investing in these instruments, it would be prudent to provide additional supplementary information on the service offered. To meet the information obligation in this respect, considering the specific nature of investing in highly leveraged derivatives, the investment firm ought to present a practical aspect related to the purchase and sale of OTC derivatives by clients through the investment firm, i.e. present the clients' past investment experience on this market in terms of an achieved rate of return (investment profitability).

Obtaining this kind of information should be considered as part of the obligation to act in accordance with the client's best interests when presenting detailed information on the service offered and investment risk related to financial instruments concerned, as it guarantees that the client or a prospective client makes pragmatic and rational decisions.

In order to implement this Guideline, the investment firm, which executes clients' orders and keeps relevant records of derivatives and cash accounts for the clients, should:

- on its website, regularly post data on results achieved by clients on the OTC derivatives market as part of its order execution service and, in order to ensure that the presented data are up-to-date, the data should be presented at the beginning of each quarter and include investment results of clients for the previous quarter,
- in the data presented, indicate a share of active clients entering into transactions on the OTC derivatives market who, during the previous quarter of a calendar year, incurred realised loss, achieved realised profit or demonstrated neither loss nor profit, broken down according to, at least:
  - a) the following classes of derivatives:
    - currency contracts for difference (Forex CFDs),
    - equity contracts for difference (Equity CFDs),
    - commodity contracts for difference (Commodity CFDs),
    - index contracts for difference (Index CFDs),
    - bond and interest rate contracts for difference (Bond/Interest Rate CFDs),
    - options,
    - other derivatives covered by transactions on the OTC derivatives market;
  - b) the minimum margin required for entering into transactions in a derivative,
  - c) the number of active clients subject to assessment, provided that it is justified by the obligation to provide data in a reliable, clear and not misleading manner,
- when making calculations:
  - understand the client as any entity (a legal person, a natural person, an organisational unit without legal personality, but being an entity governed by law) that concluded or had a valid contract for executing orders and keeping relevant records of derivatives and a cash account in a given quarter, including cases of terminating such a contract in the period indicated,
  - understand profit/loss as a net result achieved by the client in a given quarter from all executed orders (realised transactions) for the benefit of this client,
- in the case of prospective clients or clients concluding a contract for providing brokerage services consisting in executing orders for the benefit of an ordering party or keeping relevant records of derivatives and a cash account, provide the last information, which was posted on its website, on results achieved by clients on the OTC derivatives market prior to concluding the contract.

## **Guideline 10**

*In a contract for providing brokerage services on the OTC derivatives market and in regulations for providing brokerage services on the OTC derivatives market, the investment firm shall use terminology consistent with law, primarily as regards identifying the type of services and financial instruments which are covered by the contract. In defining types of financial instruments, which are covered by a specific brokerage service, the investment firm may also use terminology commonly used in trading on the OTC derivatives market, primarily*

*the one provided for in general terms and conditions of the contract, specified by organisations which bring together participants of the market.*

Main legal basis: Article 83a(3) of the Act on trading and § 8(1), § 24(1), § 24(13) and § 24(14) (3) and (5) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms.

1. The investment firm shall provide brokerage services on the OTC derivatives market under a contract concluded with the client and a rulebook for providing brokerage services. These documents use varying terminology both to determine activities performed by the investment firm and with regard to financial instruments covered by purchase or sale orders on this market.
2. At the same time, it should be noted that financial instrument designations, which are equivalent to terminology used by law or which clarify a financial instrument within a given class, were developed in OTC derivatives market trade practice. Definitions, which were established and fixed in the activity of market participants, are also used in standardised contractual terms and conditions relating to derivatives developed by organisations which bring together participants of the OTC derivatives market. Not excluding a demand to clearly determine the client's legal situation by indicating a brokerage service localised in a conceptual framework of law and a specific financial instrument covered by that service, it should, however, be taken into account that using additional terminology in brokerage activity, which is commonly used in trade practice, may facilitate the application of developed market standards by market participants.
3. Considering that the investment firm shall act in a reliable and not misleading manner as regards the documents used, particularly contracts concluded with clients, the firm should:
  - use terminology consistent with the Act on trading to describe: provided brokerage services and activities performed in connection therewith, financial instruments covered by client's orders on the OTC derivatives market. To define financial instruments covered by a specific brokerage service, the investment firm may complementarily use terminology commonly used in OTC derivatives market trade practice,
  - describe the adopted business model in a manner corresponding to types of brokerage services which serve to realise that model (market maker, ECN, NDD, STP, etc.).

### **Guideline 11**

*In a contract for providing brokerage services on the OTC derivative market, the investment firm shall include reliable, accurate and complete information on fees, commissions and other costs incurred by clients or cash benefits received by the investment firm from clients or third parties with regard to the contract with the client and its implementation.*

Main legal basis: Article 83a(3) of the Act on trading, § 8(1), 9(1) and § 24(1) and § 24(13) (4) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms.

1. The investment firm shall provide the client or a prospective client with all information necessary to decide whether to conclude a contract for providing brokerage services with the investment firm and accept its terms and conditions.
2. One of the main factors, which determine whether the investment firm's offer on the OTC derivatives market is attractive, is the way of charging clients for concluded transactions.

With regard to contracts for difference, depending on the adopted business model, the investment firm shall add its profit margin to the spread or charge a commission and add swap points.

3. Given the foregoing, the investment firm should:

- specify types of costs to be borne by the client in connection with entering into transactions on the OTC derivatives market and include such information in documents which form an integral part of a contract for providing brokerage services so that the client or a prospective client has no doubt as to fees, commissions and other cash benefits incurred, received and transferred by the investment firm in connection with providing brokerage services,
- present the information referred to above in a complete and understandable manner,
- in information on the spread made available to clients, include data on the amount (size) of the profit margin (i.e. mark-up) which is added to the market spread (received from quotation providers) by the investment firm. The profit margin should be declared as a cost borne by the client for the benefit of the investment firm,
- in information on swap points, include data on the amount (size) of the profit margin of the investment firm used to calculate swap point value. The profit margin should be declared as a cost borne by the client for the benefit of the investment firm,
- identify all costs incurred by the client for the benefit of the investment firm and, in an understandable manner, include information related to them in documents transferred to a prospective client prior to concluding a contract. These costs should be explicitly qualified as costs borne by the client for the benefit of the investment firm. If the price of shares, which are an underlying instrument for contracts for difference, is adjusted as a result of the so-called cut-off of the right to dividend, investment firms shall charge accounts of short-position holders in contracts for difference based on the price of shares and, at the same time, credit positions of long-position holders in these contracts for difference (account charge and credit value should be the same). It is impossible that the value credited by investment firms to accounts of long-position holders be reduced by the so-called "tax" whose collection by investment firms is unauthorised. It is therefore impossible to classify the so-called "tax" by investment firms as a cost incurred by the client.

## **Guideline 12**

*In a reliable, accurate and not misleading manner, the investment firm shall establish rights and obligations of parties to a contract for providing brokerage services on the OTC derivatives market and shall set out the mode and conditions of their provision.*

Main legal basis: Article 83a(3) of the Act on trading, § 8(1), § 10(2) (6)-(12) in conjunction with § 10(1), § 14 and § 24-25 of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms.

1. Regulations for providing brokerage services on the OTC derivatives market are an integral part of a contract concluded with the client by the investment firm. These regulations should include complete and clear provisions which standardise the manner of providing brokerage services on the OTC derivatives market as well as rights and

obligations of the parties to the contract.

2. The content of contracts concluded with clients and regulations for providing brokerage services should be subject to systematic internal verification and control by the investment firm to the extent referred to in the PFSA Office's Statement of 11 February 2014 (ref.: DOK/075/6/17-23/13/14/PD).
3. In order to implement this Guideline, the investment firm should, *inter alia*:
  - define terms used in the regulations in accordance with the Act on trading and implementing acts issued thereunder,
  - in regulations for providing brokerage services, indicate generic sources of quotations of financial instruments (e.g. financial institutions, news agencies), which are covered by clients' purchase or sale orders, used by the investment firm,
  - publicise names of specific institutions, which are providers of quotations of financial instruments covered by clients' purchase or sale orders, in a manner and form set forth in regulations for providing brokerage services (e.g. by publishing them on the investment firm's website by way of an order),
  - in regulations for providing brokerage services, indicate generic sources of quotations of financial instruments (e.g. financial institutions, news agencies) which are recognised by the investment firm as a reference price for the quotation of financial instruments by the investment firm when executing clients' orders, including primarily as regards the client's complaint concerning the quotation of a contract for difference or another OTC derivative covered by transactions entered into by the client of the investment firm,
  - make public the names of specific institutions, which are providers of quotations of financial instruments recognised by the investment firm as a reference price for quotations of financial instruments by the investment firm when executing clients' orders, in a manner and form set forth in regulations for providing brokerage services (e.g. by publishing them on the investment firm's website by way of an order),
  - in a rulebook for providing brokerage services, include the client's effective right to request information on the quotation of an entity which, at the time of order execution, was a basis for the quotation of the investment firm. It is important that the client receives information on a specific institution being a data provider for a given quotation recognised by the investment firm as a market quotation,
  - provide for the fact that minimum margin level is a materially important condition for the transaction entered into and any changes in the level of the margin, when holding an open position, should be introduced at least after informing the client long enough before introducing a change, provided that the margin level can be changed immediately after notifying the client in cases of force majeure and in cases where extraordinary volatility of underlying instrument prices, loss of or a significant decrease in liquidity on the underlying instrument market or other extraordinary market events on the underlying instrument market occur or the investment firm has a justified reason for suspecting that they will immediately occur,
  - clearly inform the client that free funds, which remain on his/her cash account and which are not covered by the margin at the time of entering into a transaction, may be used by the investment firm to top up the margin, without prior notification to

the client – if the investment firm applies such a solution, however, the investment firm should also obtain the client's clear prior consent to have his/her funds used in such a way,

- determine principles for executing clients' orders if the investment firm's adopted business model makes it possible to execute an order at a price specified by the client in the order (i.e. Instant Execution model), i.e. when the price of an instrument expressed in quotations of the investment firm's transaction system and reflected in the order at the time of placing that order by the client (registration of the order in the investment firm's transaction system) or activating the order (as regards pending orders) differs from the price expressed in quotations at the moment in which the order would be executed by the transaction system. The introduction of such provisions in a document, which defines rights and obligations of both parties to a contract, stems from the fact that rapidly changing market conditions cause highly intense price volatility. Price parameters set by the client in the placed order may therefore differ from the quotation of the instrument at the moment in which the order is actually executed (i.e. price slippage). This means that the value of the financial instrument could differ from the value specified in the order by the client already at the moment of order execution, thus resulting in the client's profit or loss. Therefore, the investment firm should thoroughly, clearly and accurately specify, in the regulations, a procedure for executing the client's orders when the price specified in the order deviates from the market price as at the moment of order execution (hereinafter referred to as "deviation"). At the same time, the investment firm's conduct should guarantee symmetrical rights and obligations of both parties to the contract for providing a brokerage service (in order to guarantee that contractual provisions be effectively and properly implemented, the investment firm should also introduce, while following internal procedures, appropriate technical settings in its transaction system). For this purpose, the investment firm should primarily:
  - i. determine whether it allows for order execution with deviation from the market price when executing clients' orders,
  - ii. if order execution with deviation is allowed, specify – in regulations for providing brokerage services or a document issued thereunder – parameters of acceptable deviation, i.e. its objective price range (expressed in quotation units) under which an order is still executed under terms and conditions set forth in the order, and – after exceeding the parametre – the order may be rejected or executed, upon the client's prior consent, at a new price (i.e. requote) resulting from deviation,
  - iii. symmetrically define rights and obligations of the investment firm and the client resulting from deviation. This means that, if the investment firm allows for deviation and executes an order within a specific deviation parametre, it is subject to symmetry, i.e. the order within the same price range is executed, regardless of whether execution conditions are unfavourable or favourable for the client. Similarly, when price deviation parametres are exceeded, conditions for rejecting the order to be executed or conditions for executing it at a new price, upon the client's consent, should be symmetrical for both parties to a contract. If the investment firm intends to adopt a varied approach to a different price parametre for different client categories, e.g. depending on the size of the order, the regulations or a document issued thereunder, while maintaining symmetric

rights and obligations, should clearly define objective criteria determining different procedures.

In view of the foregoing, it should also be pointed out that the investment firm commits a serious breach of the requirement to act in accordance with the client's best interests and the obligation to execute the client's order when it, *inter alia*:

- ✓ expects deviation in order execution, but fails to notify the client thereof,
  - ✓ expects deviation in order execution, but executes only these orders which are unfavourable for the client or executes an order, regardless of whether execution conditions are favourable or unfavourable for the client, but both these parameters differ from each other and favour the investment firm,
- when the investment firm adopts a business model which provides for the execution of an order if the client does not provide for a price, as a specific value, in the order and allows for executing the order at an available market price (i.e. Market Execution model), not apply provisions to determine the way of executing clients' orders which would not fully implement the client's statement of intent in determining the price. When the client places the order in which s/he does not specify clearly the price of a financial instrument or specifies it in pending orders, but allows for executing the order after its activation at the available market price, the price will be the value expressed in a quotation, existing at the moment of order execution. Due to rapidly changing market conditions, this value may differ from the value at the time when the client placed the order or when the order was activated – in the case of pending orders (i.e. price slippage). The existence of a such difference in this time interval for the benefit of the client, however, shall not mean that the investment firm is entitled to collect any cash value due solely to a favourable price trend in place as a result of which the order is executed at a price more favourable for the client. As a matter of fact, the investment firm made a commitment to the client that the order would be executed at the price expressed in the quotation at the moment of execution. Collecting the benefits referred to above shall not fall within a category allowing for collecting a fee or a commission and shall constitute improper performance of a contract of mandate by the investment firm as well;
  - not apply provisions which introduce discretion for the investment firm with regard to terms and conditions of the transactions entered into, as such discretion may cause a breach of civil law provisions which govern the conclusion of a sales contract between the investment firm and the client, i.e. execution of a transaction to purchase or sell an OTC derivative as a result of executing the client's order. For this purpose, the investment firm should primarily:
    - i. define an incorrect quotation of derivative prices, provided that such a quotation may be recognised as incorrect only as a result of objective events and is not subject to discretion on the part of the investment firm. The definition should contain precise information on incorrect quotations so as to allow the client, after ascertaining by the investment firm that such an incorrect quotation was made, to verify, on the basis of the regulations and objective data, whether this incorrect quotation really occurred. The investment firm should also define the scope of its liability in the event of an intentional or unintentional error in this respect,



- ii. define terms and conditions of recalling (cancelling) a valid and effectively concluded transaction by the investment firm or the client, subject to the principle of symmetry of the parties thereto, including specifying the date on which and circumstances under which a party to the contract, i.e. both the investment firm and the client, may exercise the right to terminate the concluded contract, i.e. cancel the transaction, and notify the client of risk that, in certain defined cases, the client's previously closed position may be restored as a result of recall (cancellation) which puts the client at risk that the position will be further held and s/he will suffer greater losses or will have the "stop out" mechanism activated on his/her account, provided that this right on the part of the investment firm is limited to cases of incorrect quotations which are catalogued in regulations for providing brokerage services, resulting in recalling the transaction from its transaction system. In regulations for providing brokerage services, the investment firm should also indicate that the right to terminate the contract shall not exclude the investment firm's contractual liability towards the client,
- iii. define terms and conditions of correcting an effectively concluded transaction by the investment firm, subject to the need of prior notification to the client and obtaining his/her consent within a specified period to comply with civil law provisions, provided that the client, at the time of giving this consent, will be informed to which transaction correction terms and conditions it pertains. It is unacceptable for the investment firm to include, in regulations for providing brokerage services, a provision by virtue of which the client gives a general consent to correcting transactions by the investment firm and the fact of placing each order confirms that consent. Transaction correction terms and conditions should make it clear when the investment firm is entitled to correct prices of concluded transactions so that the client could verify whether such transaction correction was justified (as a result of re quoting its price), specify the date on which and circumstances under which a party to the contract, i.e. both the investment firm and the client, may exercise the right to correct transactions,
- iv. provide the client with information on the execution of his/her orders ("stop loss" order), in particular information on the risk of executing the "stop loss" order at a lower price than indicated by the client in his/her order.
  - clearly specify the status of assets entrusted by the client, i.e. the client shall enjoy rights under financial instruments and shall be entitled to claim for refund, and discharge any obligations required by law, in particular obtaining the client's written separate consent to such entrustment, if a solution which does not ensure such protection is selected,
  - ensure that the client's order to withdraw funds will be executed by the investment firm without undue delay, but no later than the time limit set out in regulations for the mode and terms and conditions of managing a cash account.

***Provision of brokerage services of managing portfolios which include one or more financial instruments from the OTC derivatives market***

### **Guideline 13**

*The investment firm shall develop and apply investment strategies which include reliable, clear and not misleading information on: portfolio composition, investment limits, an objective financial index to which results of the client's portfolio with a specified investment strategy will be compared and principles for using the client's funds in connection with managing the portfolio which includes one or more financial instruments on the OTC derivatives market.*

Main legal basis: Article 83a(2) and (3) of the Act on trading, § 8(1), § 9(1) and § 12 of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms.

1. The development of brokerage services on the OTC derivatives market applies to both kinds of available financial instruments, which may be covered by transactions, and business models for offering these services. Investment firms increasingly often offer a service of managing portfolios, which include one or more financial instruments, on this market. Management activities shall be conducted on the basis of a contract as part of which the investment firm makes a commitment to the client to purchase and sell contracts for difference and other OTC derivatives under funds entrusted by the client for management according to a specific investment strategy.
2. Based on information contained in a description of a given investment strategy, the client or a prospective client shall decide on the selection of a brokerage service and its provider. Based on this document, the client shall also verify the way management brokerage services are provided to him/her, including the way his/her funds are allocated in financial instruments, the effectiveness of a managing entity with regard to achieved rates of return and incurred management costs. Given the foregoing, a special obligation to remain reliable by the investment firm when notifying the client of aspects, which may affect his/her decisions, should be noted.
3. The investment firm should therefore provide the following in its investment strategies:
  - portfolio composition in a given investment strategy which should precisely reflect groups of financial instruments within the client's portfolio to be purchased or sold,
  - a description of financial instruments which must correlate with the name of a strategy. If a strategy, which assumes a specified risk acceptance level, is executed, the description of a financial instrument should correspond to the strategy's assumptions,
  - clarification of a catalogue of financial instruments which may be purchased or sold under different investment strategies. Such action will ensure that the material scope of actions of the investment firm, as a managing entity, resulting from a concluded contract, determined by the result of an assessment of suitability of brokerage services and financial instruments, be clearly specified,
  - a description of financial instruments and investment risk they entail, developed so as to enable the client or a prospective client to make an informed decision on the selection of a given investment strategy, adapting the scope of this information to the type of a financial instrument and the client's category,
  - information on investment risk, investment limits applicable to the allocation of clients' funds and objective financial indices to which results of the client's portfolio with a specified investment strategy will be compared and which, along

with the description of financial instruments in a given investment strategy, will enable the client or a prospective client to understand the difference between investment strategies offered by the investment firm,

- understandable and reliable information on risks entailed by potential investments in financial instruments in a given investment strategy, on how these risks may be reflected in investments based on a given strategy. It is important that the client is fully aware of potential risk, which the selection of a specific strategy may entail, and of possible financial losses if specified assumptions of the strategy are not met. Information on risk entailed by a specified investment strategy should be presented thoroughly and specifically, avoiding too general and incomprehensible content. Information on risk should be complete, reliable and clear as to its actual level,
  - clarification that entering into transactions as part of portfolio management on the OTC derivatives market, due to high volatility in quotations and characteristics of derivatives, is not – as a rule – a long-term investment, but rather a short-term speculation (achieving profit or loss in a short period of time). An exception to this rule is a situation when the investment firm, which manages a portfolio, enters into transactions hedging other positions in the client's portfolio.
4. Since the purchase of contracts for difference requires blocking part of the margin, investment firms shall use only part of clients' funds to enter into transactions. Given high volatility on the OTC derivatives market, such action shall also be intended to mitigate the risk of losing funds entrusted by the client for management too quickly. Therefore, the investment firm should notify the client of the way of allocating his/her funds entrusted for management on the OTC derivatives market.
  5. In the case of promotional and advertising information or information included in an investment strategy and regarding the investment firm's declaration to guarantee that the client is provided with the so-called protection of capital invested in connection with portfolio management, the investment firm should ensure that the client clearly understands that, due to the nature of OTC financial instruments, the declared protection of capital invested means that the investment firm invests only a specific part of the client's funds in purchasing OTC derivatives for and selling them from his/her portfolio. However, if losses in open or closed positions on OTC financial instruments occur, the investment firm, which manages the client's portfolio, shall top up the required margin to the necessary level. Therefore, the declared protection of capital invested by the client is neither absolute nor guaranteed. Terminology used in and the form of presented information must not suggest to the client that capital invested by him/her is protected and that loss will not exceed value indicated in the investment strategy.

#### **Guideline 14**

*The investment firm shall apply technical, organisational and legal solutions which ensure prevention of conflicts of interests, equal treatment of clients and acting in accordance with the client's best interests when providing brokerage services of managing a portfolio which includes one or more financial instruments on the OTC derivatives market.*

Main legal basis: Article 75(1), Article 73(5a)-(5h) and Article 83a(1) and (3) of the Act on trading, § 8(1), § 9(1), § 23(1)-(5), § 27 and § 28(7) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms and § 3(1)-(5) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions.

1. Activities of managing clients' portfolios on the OTC derivatives market shall be performed on transaction platforms ensured by Polish or foreign investment firms which provide brokerage services consisting in executing orders for the benefit of the client who places orders on the OTC derivatives market. Therefore, portfolios, i.e. accounts on which placed orders and concluded transactions, including their settlement, are recorded, shall be managed in two ways:
  - a) by performing individual analyses of clients' portfolios by the investment firm which manages them – in this case, the investment firm, on its own behalf, shall conclude, with foreign brokers, contracts for managing an account of financial instruments and a cash account for the benefit of its clients. Orders shall be placed and transactions shall be entered into and settled on an account managed for the benefit of the investment firm and then properly reflected in clients' portfolios;
  - b) by using accounts, which clients opened with a different broker, by the investment firm which manages portfolios – in this case, the investment firm shall act as an agent for these accounts on which it shall enter into transactions, but it shall not be responsible for conducting analyses thereof, shall not accept any payments and shall not withdraw clients' funds.
2. In conjunction with paragraph 1(a), the investment firm, in order to duly protect the client's funds entrusted for management, should:
  - a) conclude, with a foreign broker, a contract for managing a summary account, on which both financial instruments and funds are recorded, guaranteeing that, under law, clients of the investment firm enjoy rights arising out of purchased financial instruments and, if a solution not ensuring such protection is selected, that any obligations required by law, in particular obtaining the client's written separate consent to such entrustment, are discharged;
  - b) include, in regulations for providing brokerage services, with regard to managing portfolios, relevant provisions governing mutual rights and obligations of parties to a contract for managing portfolios, taking into account the fact of providing the brokerage services referred to in Article 69(2) (2) and Article 69(4) (1) of the Act on trading to the client by another entity.
3. Transactions on clients' portfolios shall be entered into by using the so-called financial leverage. This mechanism allows for making operations more profitable while involving fewer funds than would have been required for a transaction in underlying instruments. The maximum leverage shall depend on a broker which executes orders of the firm managing the client's portfolio (financial leverage multiplies both profits and losses). Therefore, the investment firm should apply financial leverage up to the level determined by the Polish legislator.
4. The margin shall be necessary to enter into transactions in contracts for difference. The margin shall be blocked, when a transaction is concluded based on an order of the firm managing the client's portfolio, by blocking an appropriate amount of funds. Therefore, if the firm managing clients' portfolios:
  - a) manages cash accounts for the benefit of clients and uses an account at a foreign broker, where it keeps clients' funds, for which the margin is established globally;
  - b) uses clients' individual accounts opened with a different broker, the margin shall be determined through blocking, in the client's fund register, an amount of funds agreed according to principles described in a given investment firm's specification

of OTC derivatives, without requiring the client to place a separate order in this respect.

Therefore, the investment firm should:

- on an ongoing basis, monitor the level of the margin for each client and top it up to the required level without using funds of some clients for the benefit of other clients,
- not allow for a situation where an aggregate position in a financial instrument could be opened for all or some clients and where only the final result of a transaction, taking into account profit/loss, is distributed by the investment firm individually between subaccounts of its clients. Activity as such, i.e. consisting in the collective investment of funds entrusted by clients, shall be indicative of actions bearing the signs of illegal activity of an investment fund, since the client does not receive, under allocation to a portfolio, a specified number of single contracts for difference, but only a share in such a financial instrument and ultimately participates in his/her share of profit or loss resulting from the allocation of parts of this financial instrument which is subject to the selection of the risk level,
- clearly specify the status of funds entrusted by the client, i.e. the client shall be entitled to claim for refund, and discharge any obligations required by law, in particular obtaining the client's written separate consent to such entrustment, if a solution not ensuring such protection is selected.

#### **Guideline 15**

*To provide brokerage services of managing a portfolio, which includes one or more financial instruments on the OTC derivatives market, the investment firm shall ensure that licensed investment advisors, who have knowledge of and experience in the OTC derivatives market, constantly and actively participate in making and implementing investment decisions on purchasing and selling financial instruments to clients' portfolios.*

Main legal basis: Article 83(1) (2), Article 83a(1) and (3) of the Act on trading, § 8(1) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms and § 9(2) (1) and (2) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions.

1. The provision of this kind of brokerage services on the OTC derivatives market entails high risk for safety of funds invested by clients and thus requires the investment firm to act with utmost diligence and professionalism.
2. Pursuant to Article 83(1) (2) of the Act on trading, the investment firm shall employ at least two investment advisors to perform portfolio management activities. This condition shall be satisfied if at least two investment advisors participate in the provision of a service, i.e. take and execute investment decisions based on their professional license and a contract of employment. Therefore, the investment firm, in order to professionally and competently provide brokerage services and ensure the protection of the client's best interests, should:
  - ensure that at least two investment advisors participate on an actual and continuous basis in performing activities related to making and executing investment decisions in connection with managing clients' portfolios,
  - perform periodic analyses of the investment firm's needs related to the provision of portfolio management services on the OTC derivatives market with respect to a possible increase in the headcount of licensed investment advisors,

- provide employed investment advisors with all necessary means to properly perform their tasks, including access to materials, information and IT tools for effective and undisturbed portfolio management,
- ensure that persons, who do not hold an investment advisor license, perform only technical and auxiliary activities under the guidance and supervision of investment advisors, i.e. that they do not make or execute their own investment decisions on clients' portfolios.

### **Guideline 16**

*The investment firm shall ensure that activities related to providing brokerage services of managing a portfolio, which includes one or more financial instruments on the OTC derivatives market, be systematically and effectively supervised.*

Main legal basis: Article 83a(1) and (3) of the Act on trading, § 8(1) of the Regulation of the Minister of Finance of 24 September 2012 on the mode and conditions of conduct of investment firms as well as § 9(1) and § 9(2) (1) of the Regulation of the Minister of Finance of 24 September 2012 on determination of the detailed technical and organisational conditions.

1. High investment risk for clients of investment firms, which manage portfolios on the OTC derivatives market, may manifest itself not only due to market conditions, but also in case of insufficient due diligence and responsibility on the part of investment firms which manage the client's portfolios.
2. Irregularities in providing portfolio management services on the OTC derivatives market result from both an illegal procedure for entering into transactions on clients' portfolios and the fact that investment firms allow persons, who do not hold an investment advisor license, or investment advisors, who do not have sufficient knowledge of or experience in contracts for difference and other OTC derivatives, to manage portfolios.
3. Therefore, the investment firm should ensure:
  - competent and independent internal supervision of provided brokerage services,
  - by introducing appropriate provisions of internal regulations on the organisation of the investment firm, that members of the Management Board of the investment firm are directly liable for the way brokerage services supervised by them are provided, in particular with regard to violations of the obligation to act in accordance with the client's best interests,
  - acquisition of investment advisors who have knowledge of, and experience in, investment on the OTC derivatives market.