

Exchange Traded Funds in Poland

Exchange Traded Funds ("**ETFs**") have been familiar to investors on developed capital markets for some time now. Recently they have also become available to investors on the Warsaw Stock Exchange (the "**WSE**") on a limited basis. ETFs are among the most dynamically developing investment tools owing to their low cost for both investors and issuers and also because of their transparency.

The first ETFs emerged in 1990 in Canada and the USA. In Europe they made their debut approximately 10 years later. Currently, the global EFT market is estimated to be approximately USD 1.1 trillion in value. There are over 2.2 thousand ETFs listed in the world based on various stock exchange indices of companies, natural resources and bonds. Although the ETF market emerged relatively recently in Warsaw, it has generated significant interest among investors.

This briefing presents the Polish law issues affecting ETFs and summarises the basic rules for the listing of ETF participation units on the WSE.

Key issues

- What is an ETF?
- ETF funds in Poland
- Specific features of foreign ETFs
- Portfolio fund – a type of closed-end fund
- Listing on the WSE
- Information obligations
- Dematerialisation at the National Depository for Securities
- Commencement of listing on the WSE
- Entry of ETF participation units in the register

What is an ETF?

An ETF is an investment fund which is intended to accurately mirror a specific stock exchange index, the participation units of which are available on a regulated market. An ETF's investment policy consists of passive observation of certain values and mirroring them as closely as possible. Therefore, the ETF management style is often described as passive (as opposed to investment funds, which are managed actively). The aim of the fund is to achieve a rate of return on an investment exceeding a benchmark (i.e. a specific stock exchange index).

ETF participation units, like shares, are valued in a continuous manner (i.e. at any point in time, an investor can check how much a participation unit costs). This is one of the basic differences between ETF participation units and the participation units of an open investment fund, which are valued at specific time intervals (e.g. once a day).

Furthermore, ETF participation units may entitle the investor to more rights than an ordinary participation unit in an open fund. This could be a share in the dividends of the companies which the ETF fund is mirroring, the exercise of voting rights in respect of shares in such companies or the possibility to obtain a proportionate block of shares upon the redemption of an ETF participation unit.

ETF funds in Poland

The basic legal framework which regulates the issue of investment funds in Poland is the Act on Investment Funds of 27 May 2004 (the "**Act on Investment Funds**")

In the context of public offerings of ETF participation units and their introduction to trading on the regulated market, the provisions of the Act on Trading in Financial Instruments of 29 July 2005 and the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies of 29 July 2005 will also apply (the "**Act on Public Offering**").

Under the current legal regime, ETFs listed on the WSE may exist in Poland in two forms:

- in the form of a foreign fund which operates on the basis of the provisions of the law of its home country, and is then passported into Poland. Polish law only applies to such funds on a limited basis; or
- in the form of a portfolio fund which is a type of closed-end investment fund operating on the basis of the Act on Investment Funds.

As a result of an amendment to the relevant Polish legislation, as well as changes in the rules of the WSE, in September 2010 an ETF reflecting the WIG20 index of the WSE was listed on the main market of the WSE. In May 2011 the manager of that ETF offered ETFs reflecting the DAX index and the S&P 500 index, which are also listed on the main market of the WSE. No portfolio funds are currently listed on the WSE.

Specific features of foreign ETFs

General

The commencement of activity by a foreign fund in Poland is conditional

upon obtaining a relevant permit from the appropriate supervision authority in the fund's home country. The fund enjoys a presumption guaranteed by the institution of uniform passporting that it is a fund operating in accordance with the EU Undertakings for Collective Investment In Transferable Securities (UCITS) system.

Notification to the Polish Financial Supervision Authority (*Komisja Nadzoru Finansowego*) (the "PFSA")

In order to issue ETF participation units in Poland, a foreign fund must notify the PFSA in writing of its intention to do so. Among other things, there should be attached to the notification the rules and regulations of the fund, an information prospectus and a detailed description of how the participation units will be sold in Poland, i.e. a so-called marketing memorandum, which presents in detail the whole technical and organisational infrastructure on which the fund intends to operate in Poland. The purpose of the marketing memorandum is also to precisely present the PFSA with the potential rights and obligations of Polish investors. This is therefore a highly detailed document, and it is analysed by the PFSA with particular diligence.

A fund can start offering participation units two months from the submission of all of the required documents, unless the PFSA makes an objection in the form of an administrative decision. If it has no objections, the PFSA will enter the foreign fund in the register of foreign funds.

Entities supporting the functioning of a foreign ETF – representative and paying agent

A foreign fund is obliged to have its own representative and paying agent in Poland. The representative mainly represents the foreign fund in relations with the PFSA – e.g. in potential proceedings, and it presents information about changes in the documents submitted as part of the notification procedure. The Act on Investment Funds does not contain any limitations as to who may be a representative of a foreign fund.

On the other hand, only a local bank or a Polish branch of a credit institution may be a paying agent. The main task of the paying agent is the servicing of the fund's participants. This consists of, among other things, accepting payments for the purchase of participation units and making payments in connection with the redemption of units.

Portfolio fund – a type of closed-end fund

A Polish entity may list ETF participation units on the WSE via a specific type of closed-end fund, i.e. a portfolio fund.

A portfolio fund is a type of closed-end investment fund which issues public investment certificates in a continuous manner, investing the funds collected in a way so that one certificate corresponds to a basket of securities.

A participant in the fund may, in such case, personally exercise the voting rights at shareholders' meetings of the issuers of the securities comprising the basket. This is a significant departure from traditional

types of investment funds, in which the voting rights are exercised by the fund represented in this respect by the investment fund association managing it.

In order for investment certificates issued by a portfolio fund to be introduced to trading on the WSE as ETF certificates, the portfolio fund must invest its assets in such a way that it is based on the composition of the portfolio of securities comprising the basis for determining the value of the regulated market index.

Portfolio funds are also of note in that if the share of the stocks/shares or debt securities of one issuer in the index increases, the portfolio fund may increase the limit of the share of securities issued by an entity from 20% of its portfolio's value (this is the limit mandatory for other types of closed-end funds) to 35%.

Listing on the WSE

Despite the differences between the functioning of a portfolio fund and a foreign fund issuing ETF participation units, the procedure by which they are introduced into regulated trading is very similar, albeit with certain limited differences.

In the case of a foreign ETF fund, its notification to the PFSA in accordance with the uniform passporting rules is necessary. The prospectus of such a fund is approved in the country of its establishment, and the PFSA only receives a translation of the approved document.

On the other hand, in the case of portfolio funds, the prospectus is prepared in accordance with the Act on Public Offering. However, the granting by the PFSA of a permit for the creation of a portfolio fund also

constitutes approval of the prospectus, provided that the fund has been entered in the register of investment funds.

In such a case, the fund is obliged to file an application for the admission of its investment certificates to trading on the regulated market within seven days from the date of the fund's being entered in the register.

Information obligations

Foreign funds

The information obligations of a foreign investment fund are regulated by the Act on Investment Funds, as well as by the law in force in the fund's home country. The provisions of the Act on Public Offering also apply to a limited extent.

A foreign fund is obliged to, among other things, make available – in Polish – its information prospectus, abbreviated prospectus, any amendments made to these documents, its annual and semi-annual financial statements, as well as any information required by the provisions of law of its home country.

It should be noted that every advertisement, announcement and other piece of information should be published in Polish. The Act on Investment Funds additionally introduces an obligation to provide, at the investment fund participants' request, additional information in Polish concerning, among other things, the fund's investment limits and the manner in which investment risk is managed.

Portfolio funds

A portfolio fund is obliged to make its prospectus available to the public in

the manner specified by the Act on Public Offering.

Therefore, a portfolio fund is obliged to make its prospectus publicly available immediately after the PFSA issues a permit for the creation of the portfolio fund. In such case, a portfolio fund may publish its prospectus in a nationwide newspaper, make it available in hard copy free of charge at the WSE's head office or in electronic form on the website of the investment fund association managing it. The latter method is the most popular way of publishing an issue prospectus.

Electronic Information Transmission System

In order to fulfil their information obligations both portfolio funds and foreign funds are obliged by the provisions of the Act of Public Offering to participate in the Electronic Information Transmission System (*Elektroniczny System Przekazywania Informacji*) (the "ESPI"). As these entities are obliged to provide confidential and current information upon the admission of ETF participation units to trading on the regulated market and as obtaining the PFSA's consent to become a participant in the ESPI might take some time, the application to be granted access to the ESPI should be filed well in advance.

The scope of information which a portfolio fund is obliged to provide, and the deadlines for its submission, is regulated by Polish law. In the case of a foreign fund, pursuant to the Act on Public Offering, these matters are regulated by the provisions of law of the fund's home country.

Dematerialisation at the National Depository for Securities

ETF participation units, both those issued by a portfolio fund as well as those issued by a foreign fund, are subject to dematerialisation at the National Depository for Securities (*Krajowy Depozyt Papierów Wartościowych*) (the "KDPW").

The dematerialisation of securities takes place on the basis of an agreement entered into with the KDPW. The following documents should be attached by the fund to the application for registration: an "issue letter" for the securities (which specifies, among other things, the name of the series of the securities, the number of securities and the ISIN code), documents specifying the legal nature of the securities, documents constituting the legal grounds for the issue, and documents which make it possible to determine the admissibility of the delivery of securities to the entitled parties by way of entries on securities accounts.

A foreign ETF is additionally obliged to enclose a legal opinion specifying the conditions which must be fulfilled in order for the issue to take place and for the securities to be delivered to the parties entitled. This opinion is not required if the securities were previously registered in another depository and settlement system with which the KDPW has entered into a relevant co-operation agreement (e.g. Euroclear or Clearstream).

Commencement of listing on the WSE

The WSE's Regulations

In response to market needs, in January 2010 provisions were introduced into the WSE's regulations which make it possible to list ETF participation units on the WSE. At present, pursuant to the WSE's Regulations, the following may be admitted to trading as ETF participation units:

- participation units in a foreign sub-fund or open investment fund which has been entered in the register maintained by the PFSA; or
- investment certificates of a portfolio fund.

Applications and admission and introduction to trading

Commencement of listing of participation units on the WSE requires that an admission procedure be followed and subsequently the introduction of the securities onto a given listing market.

This means that a fund should submit two applications:

- for admission of the ETF participation units to trading, and
- for introduction of the ETF participation units to trading.

In practice both applications are submitted at the same time. The WSE's Management Board has 14 days from the date of submission of the application to issue a decision on admission and introduction to trading.

Costs

The WSE's Regulations set out fees for the introduction to trading of ETF participation units. These depend on the value of the issue and on the type

of market to which the ETF's participation units will be introduced. (For example, the fee for introducing participation units to trading on the main market of the WSE amounts to 0.03% of the issue value but not less than PLN 8,000 and not more than PLN 96,000.)

Entry of ETF participation units in the register

A public offering and subsequent admission to trading on the regulated market give rise to an obligation to notify the PFSA, which then enters the securities in a public register.

The issuer or the entity introducing the ETF units to trading is obliged to notify the PFSA twice. The first notification must take place within 14 days from the completion of the subscription or sale of the securities being the subject of the public offering. The issuer or the introducing entity is obliged to notify the PFSA for the second time within 14 days from the admission of the ETF participation units to trading on the regulated market. If the securities are introduced to trading on the regulated market in Poland in due time after the completion of the public offering, the entry into the PFSA's register is free of charge.

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