



Disclosure framework for securities settlement systems-05/2011

**DISCLOSURE FRAMEWORK FOR
SECURITIES SETTLEMENT SYSTEMS**

KDD - Central Securities Clearing Corporation,
Ljubljana, Slovenia



Disclosure framework for securities settlement systems

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1 INTRODUCTION

The Committee on Payment and Settlement System of the central banks of the Group of Ten (G-10) countries (CPSS) and the International organization of Securities Commissions (IOSCO) have demonstrated a shared concern with regard to clearance and settlement practices throughout the world. Both the CPSS and IOSCO believe that common interests in the efficiency and risk management of securities settlement systems can be advanced through collective initiatives. Consequently, in 1996 the CPSS and IOSCO formed a joint working group to develop a disclosure framework for securities settlement systems. The working group consisted of securities settlement system operators, including both official and private sector representatives, securities regulators and central bankers. Both developed and emerging markets were represented in the working group.

The goal of developing a disclosure framework for securities settlement systems (SSSs) builds on important prior work undertaken by the CPSS and IOSCO to identify risks associated with securities settlement. The 1992 CPSS report *Delivery versus Payment in Securities Settlement System (DVP Report)* defines and analyses the types and sources of risk associated with settlements between direct participants in a single settlements system. This report also clarifies the meaning of delivery-versus-payment (DVP) mechanism and describes three common approaches to achieving DVP, each of which entails different risks to market participants.

The *Cross-Border Securities Settlements report (Cross-Border Report)*, prepared by the CPSS in 1995, expands on the DVP Report by analyzing the channels that market participants use to complete cross-border securities transactions. This report outlines the different risks that may be present in these arrangements, even in those cases where DVP is achieved, including replacement cost risk, liquidity risk, cash deposit risk, custody risk and systemic risk. In particular, the report highlights the fact that custody risk will be present whenever market participants hold their securities through an intermediary, a standard practice for non-residents attempting to settle cross-border transactions.

The Cross-Border Report stresses the importance of understanding the nature of the custody risk, as well as the procedures used to effect back-to-back settlements and cross-system settlements in the cross-border context. The report concludes that the complexity of relationships between the multiple intermediaries associated with cross-border settlements poses challenges to the oversight of domestic markets and settlement systems. It notes that the most basic challenge stems from lack of transparency in cross-border securities settlement arrangements.

In 1990, IOSCO published a report in which it endorsed and supported the prompt implementation of nine recommendations by the Group of Thirty, such as shortening the time between trade date and settlement and assuring the simultaneous exchange of payment and securities. Successive reports on their implementation have also been prepared (1993, 1994, 1995 and 1996). In 1992 IOSCO published a document entitled *Clearing and Settlement in Emerging Markets – A Blueprint*, to facilitate the development of centralized, automated SSSs.

More recently, IOSCO's 1996 Report on *Cooperation Between Market Authorities and Default Procedures (IOSCO Report)* determines that transparency of market default procedures is important in that it provides certainty and predictability to market participants, facilitates orderly handling in case of an actual default and enables market participants to make an informed assessment about markets.

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These reports, as well as other work undertaken by the CPSS and IOSCO, have consistently emphasized the importance of transparency of market mechanisms. At the same time, however, growth in worldwide settlements volumes and greater use of financing transactions have required settlement system operators to develop processes for more rapid exchange of securities and funds and more efficient linkages between systems. Moreover, as prior reports have shown, apparent similarities in the technologies employed and services offered can mask significant differences in securities settlement arrangements, as well as in the approaches taken to the management of the associated risks.

Therefore, it is critical that participants in the securities markets carefully examine the rules and operating procedures and practices of each system, as well as the governing law, underlying custody arrangements and linkages across the systems. While much relevant information of this type is publicly available, it is often contained only in extensive, detailed handbooks of rules and procedures. A number of SSSs do publish informative pamphlets for their participants, but these can take a variety of forms, making it difficult for participants to assess similarities of differences in the risk management approaches used by the different systems.

To assist market participants in identifying important risks associated with their participation in SSSs, the CPSS and IOSCO therefore determined that it would be beneficial to develop jointly a disclosure framework that system operators and participants could use to gain a clearer understanding of the rights, obligations and exposures associated with SSSs. The CPSS and IOSCO welcomed the participation of a number of private sector SSS operators in the development of the disclosure framework.

The framework is intended to be completed by SSS operators for the information and benefit of their direct participants, both current and potential, as well as for indirect participants. It is not intended as an attempt to set prescriptive standards for SSSs, as a replacement for the rules and procedures of the SSS or as a legal representation or binding contract. Moreover, the framework does not necessarily identify all information that the SSS should disclose in the light of its individual facts and circumstances and therefore it may be necessary for participants to discuss issues directly with the SSS to obtain a full understanding of the system. The framework should, however, help market participants and regulators to organize and understand the information that they need in order to appraise the risks, including any systemic risks, potentially with SSSs.

While the framework focuses on the risks of direct participation in SSSs, it is clear that many of the same issues arise in connection with the relationships between market participants and local or global custodians. Therefore, while this framework is not intended to cover the specific aspects of these relationships, it may be helpful as a point of reference for those using the services of custodians as well.

The sections below are intended to elicit important information from SSSs in the areas of organizational structure and market context, ownership arrangements, rules and procedures, relationships with participants, links to other SSSs and intermediaries, procedures for funds and securities transfers, default procedures, settlement of back-to back transactions, risk control measures and operational risks. The disclosure framework is structured in the form of a questionnaire, which SSSs would complete. The CPSS and IOSCO encourage SSSs to complete the questionnaire and make their responses available to market participants, regulators and other interested parties. To ensure that the information in their responses to the questionnaire remains accurate, SSSs would also need to review their responses periodically, at least annually, and make

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appropriate changes if necessary. The questionnaires completed by SSSs would therefore serve to increase the transparency of their operations to the market place.

2 BASIC INFORMATION

This section addresses a number of fundamental features of the SSS, and provides the market context for its operation. This questions establish the basic functions of the SSS, including the securities for which it provides settlement services, as well a whether the SSS offers other services. Questions on the organizational and ownership structure of the SSS elicit information on it legal basis and corporate governance.

A wide variety of organizational structures and business functions are possible for SSSs. For example, systems may be owned by central banks, by their participants or by an independent private sector entity that may or may not be operated for profit. It is helpful to distinguish the type of ownership, the organizational and decision making structure of the SSS and the financial resource of the SSS, as well as the supervisory oversight to which the system is subject, as a first step in clarifying the respective responsibilities of all relevant parties.

A. What is the name of the SSS:

KDD - Central Securities Clearing Corporation (hereinafter referred to as "KDD").

B. Location and Time Zone:

KDD is located in Ljubljana, capital of the Republic of Slovenia. CET Zone.
Address: KDD; Tivolska 48; 1542 Ljubljana; Republic of Slovenia.

C. Functions:

The functions of the KDD are (pursuant to Markets in Financial Instruments Act - hereinafter referred to as "ZTFI"):

- Maintenance of central registry of dematerialised securities (issue, cancellation and replacement of dematerialised securities, share ledger maintenance, ISIN allocation);
- Operation of securities settlement system for securities trades executed on organised market (pursuant to ZTFI, stock exchange transactions with dematerialized securities, entered in central registry of dematerialized securities, shall be settled through the clearing and settlement system operated by the operator of the said central registry, unless stock exchange decides that settlement services are executed with other settlement system);
- Other services:
 - specific custody services related to corporate actions of issuers;
 - custody services related to take-over bid procedures;
 - settlement of OTC transactions with dematerialized securities either on DVP or FOP basis;
 - entitlement processing (dividend and interest payments). This service is provided on optional basis;
 - other services related to operations with dematerialized securities and fulfilment of rights derived therefrom;
 - sales and maintenance of software for supporting services listed above.

Does the SSS serve as a securities depository and/or provide securities settlement services?

KDD serves both as a securities depository and as a provider of securities settlement services. KDD acts in the capacity of Slovenian national CSD (the only CSD in Slovenia) and serves as:

- securities settlement system (with clearing function),

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- depository,
- registrar.

Book Entry Securities Act (hereinafter referred to as “ZNVP”) sets forth a coherent set of provisions regulating all legal issues regarding dematerialized securities. KDD Operations Rules (hereinafter referred to as “KDD Rules”) comprise detailed provisions of those issues. ZNVP gives the following definitions of legal terms, used in its provisions:

Pursuant to provisions of ZNVP *Central registry of dematerialised securities* is a central electronic database into which the following are subject to entry:

- the rights arising from dematerialised securities,
- holders of these rights, and
- third party rights to such securities.

Pursuant to ZNVP, central registry of dematerialised securities is maintained (operated) by an entity that has acquired Securities Market Agency’s licence for maintenance of securities settlement system. At the moment, KDD is the only entity in the Republic of Slovenia that has acquired such a licence. KDD therefore acts as the only central depository in the Republic of Slovenia.

KDD maintains the *securities settlement system*. KDD’s securities settlement system is designed for settlement of All transactions concluded on the Ljubljana Stock Exchange. Pursuant to ZTFI, stock exchange transactions with dematerialized securities, entered in central registry of dematerialized securities, shall be settled through the clearing and settlement system operated by the operator of the said central registry, unless stock exchange decides that settlement services are executed with other settlement system.

Pursuant to provisions of ZTFI, *maintenance of the central registry* means performing of entries in the central registry with respect to:

- the issue, cancellation or replacement of dematerialised securities;
- transfer of dematerialised securities between the accounts of holders;
- the entry (registration), modification or deletion of third party rights or legal facts related to dematerialised securities.

Securities accounts that are maintained directly in the central registry are operated by **KDD members** (banks, stock-broking companies, management companies, insurance companies, pension funds, governmental funds, central bank). Operating the securities accounts in this context means having the ability to enter orders regarding the securities registered on such securities account, whereby the execution of these orders is subject to predefined (general and specific) requirements.

Pursuant KDD Rules under the “Contract of accession to system of dematerialized securities accounts maintenance”, KDD allows KDD member to use the *Information system of dematerialized securities accounts maintenance* in accordance with the requirements and in the manner set forth in KDD Rules and Regulations and, to the extent required:

- to open and close accounts maintained by the member pursuant to KDD Rules or Regulations,
- to enter orders, as the member may be authorized pursuant to KDD Rules or Regulations,
- to access data regarding accounts and
- to perform other acts with respect to maintenance of accounts as enabled by the information system of dematerialized securities accounts maintenance,

provided that the member pays KDD the according compensation determined by the tariff of KDD.

System of dematerialized securities accounts maintenance is defined in KDD Rules as the legal relationship between KDD members and KDD setting forth their mutual rights and obligations with respect to maintenance of dematerialized securities accounts.

Information system of dematerialized securities accounts maintenance is defined in KDD Rules as a computer system maintained by KDD that supports the maintenance of central registry.

1.1 What types of instruments are eligible for deposit at the SSS?

ZNVP gives a very general (broad) definition of dematerialized securities. ZNVP defines a (dematerialized) security as: “A dematerialized security is a statement of the issuer entered in the central registry of dematerialized securities by which the issuer undertakes to fulfil all obligations embodied in the security to a person who is as a legal holder of the security entered into the central registry.”

Therefore, a dematerialized security according to ZNVP means any financial instrument that embodies entitlements (i.e. holder's rights) that can be exercised against the issuer.

Pursuant ZTFI, an issuer whose registered office is in the Republic of Slovenia and who has made such initial public offering of its securities that publication of prospectus was mandatory or who seeks their admittance to trading on organized market is obliged to issue the securities in dematerialized form. Additionally, all joint stock companies are obliged to issue their shares in dematerialized form (pursuant to Companies Act – hereinafter referred to as “ZGD-1”).

Therefore, at present day, having dematerialized securities entered in central registry is a standard form of holding the securities.

1.2 What types of instruments are eligible for transfer within the SSS?

All securities eligible for deposit at KDD are also eligible for transfer within KDD.

1.3 Are eligible securities dematerialised, immobilized or transferred physically?

All eligible securities are dematerialised.

1.4 Does the SSS provide safekeeping for physical certificates?

No, KDD operates in completely dematerialised environment.

2. Does SSS provide cash accounts and/or provide funds transfers in conjunction with securities transfers? Is so, in what currencies?

No, KDD does not provide (operate) cash accounts for its members. However, KDD intermediates in the transfer of funds between cash accounts in relation to the securities transfers. This applies to the execution of settlement of operations related to stock exchange trades and for the off-market (OTC-DVP) trades.

All fund transfers are denominated in Euros.

3. Does the SSS provide a trade matching service? Do other provide such services for securities settled in the SSS?

Yes, KDD provides a trade matching service for off-market (OTC-DVP) trades through its information system of dematerialised securities accounts maintenance. This requires one party to enter and other party to confirm entered trade details, before the settlement is eligible for execution.

Trading on the Ljubljana Stock Exchange market is done through the Ljubljana Stock Exchange trading information system, which means that KDD receives already matched and locked-in trades and therefore does not perform matching services for the organized market. For further details on matching please see Chapter 6.

4. Does the SSS provide a trade netting service (as distinct from undertaking the settlement of securities on a net basis)? Do others provide such services for securities settled at the SSS? In either case, what types of netting (bilateral or multilateral), if any, are performed?

Yes, KDD provides a cash netting service (technical netting) for all securities transactions concluded on the Ljubljana Stock Exchange (no netting is applied to OTC transactions). The netting performed by KDD is multilateral. KDD is the only provider of such netting services.

5. Does the SSS offer a securities lending or borrowing program?

No, at present, the lending service is being performed on a bilateral basis between members only (using OTC-DVP or OTC-FOP settlement mechanisms).

6. Does the SSS provide custodial and/or related services such as collection of interests, dividends, principal or withholding tax reclamation? Which type of services are provided?

KDD does not have a banking license and is prohibited by law from exposing to credit risk, therefore it is entitled to offer only limited set of custodial services.

KDD provides the following custody related services: securities accounts management, corporate actions (issuance, cancellation and replacement of dematerialised securities, take-over bid procedures, mergers, squeeze outs, spin offs, share capital reductions and other corporate actions processing from CSD perspective), entitlements processing (payment of dividends or interests to the entitled owners).

7. Does the SSS act as a central counterparty or principal to transactions with its participants?

No, KDD does not perform services or functions where it would act as a principal and does not grant any cash credits nor provide any securities loans.

To avoid any exposure of KDD to credit risk (pursuant to provisions of ZTFI):

- KDD may not act as Central counterparty and
- KDD, in relation to settlement of stock exchange (or any other) transactions with securities, or in relation to payment obligations derived from the rights embodied in the securities (dividends, interests), may not expose itself by assuming any payment obligations of settlement members, issuers or any other persons/entities, or engage in any other activities whereby it would assume credit risk.

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8. Other? Please specify.

Not applicable.

D. What type of organization is the SSS?

1. Please indicate whether the SSS is a public or private sector entity?

KDD is a private sector entity.

2. Please indicate whether the SSS is organized on a for-profit or non-profit basis.

The KDD is a private joint-stock company that operates on a for-profit basis.

3. What is the legal basis for the establishment of the SSS and for securities transfers made through it?

Legal framework for establishment and operations of KDD:

- Markets in Financial Instruments Act (ZTFI);
- Book Entry Securities Act (ZNVP);
- Investment Trusts and Management Companies Act (ZISDU-1);
- Mergers and Acquisitions Act (ZPre-1);
- Subordinate Legislation.

E. Organizational and ownership structure:

1. Who are the owners of the SSS?

As of 31 December 2010, KDD had 31 shareholders which could be distributed into four major ownership groups: banks (17,3%), government funds (24%), management companies (15,4%), others (43,3%).

2. What entity or entities operate the SSS? Which functions of the SSS, if any, are outsourced to third parties?

KDD operates its own SSS for all dematerialised securities. No functions are outsourced.

3. Does the SSS have a Board of Directors?

Yes, KDD has (presently) a five-member Board of Directors.

3.1 What is its composition?

There are four representatives of KDD shareholders and one representative of KDD in the Board of Directors.

3.2 What are its responsibilities?

Principal duties of The Board of Directors are to supervise the conduct of the KDD's business, inspect all KDD's books and documentation, demand written reports, approve the general terms of business and other general rules of KDD referring to its business activity and relations between

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KDD and its members. The Board of Directors also reviews annual reports, audit reports and Management Board's proposal for distribution of balance sheet profit. It is elected by the General Meeting of Shareholders for a period of four financial years.

F. Please describe the financial resources of the SSS:

1. Amount of paid-in capital and retained earnings?

Paid-in capital: 1.084.961 EUR

Retained earnings: 1.155.926 EUR (as of 31. December 2010).

2. Guarantees, insurance coverage or other similar arrangements?

Following risks are covered through insurance policies listed below (as of 31. December 2010):

- insurance policy for operational errors, omissions, computer fraud (coverage 1 mn €, deductible 2.000 €);
- insurance policy for computer equipment, office furniture and other office equipment (coverage 1,4 mn €, no deduction);
- insurance policy for entire building (KDD premises represent just a part of it).

3. Credit lines or letters of credit ?

Not applicable.

4. Powers to asses participants or equity holders?

Not applicable.

G. Please describe whether the SSS or its operator is subject to authorization, supervision or oversight by an external authority?

KDD is subject to supervision of the following (external) authorities:

- prudential supervision by Securities market agency in the capacity of competent authority for supervision of organized markets and investment services,
- supervision by the Bank of Slovenia in respect of systemic risk of settlement system and in the capacity of operator/manager of national component of RTGS TARGET2 payment system,
- audit of tax statements by the Tax Administration Office,
- external (statutory) audit of accounting documents by independent auditing company.

3 RULES AND PROCEDURES OF THE SSS

It is important that SSSs have clear rules and procedures governing all major aspects of their operations. If participants have access to these rules and procedures, they will be able to form clear expectations about the actions of the SSS and will be able to use their understanding to make decisions on that basis. This is particularly important with regard to the resolution of failures to settle or other potential disruptions to the operation of the SSS.

The rules and procedures also typically describe the structures and processes for taking decisions that are at the core of any organization's corporate governance. For SSS operators, the integrity of the decision-making processes and the means for communicating decisions is important to the level of confidence participants have in the system's ability to manage risk fairly and effectively.

The questions below focus broadly on how participants can obtain copies of the SSSs rules and procedures, how participants can provide input to the rules and procedures, how they are notified of changes, the applicability of the rules and procedures to the SSS as well as its participants, and the circumstances under which the rules and procedures can be overridden. Taken together, the questions are intended to provide participants with an understanding of the role that the system's rules and procedures play within the operation of the SSS.

RULES AND PROCEDURES OF KDD

A. Does the SSS maintain a complete list of the rules and procedures governing the rights and obligations of participants and the duties of the SSS?

Detailed provisions regulating KDD's operations and relations to its members are comprised in KDD Rules. KDD rules are directly applicable against KDD members, issuers and other users of KDD's services.

Provisions on KDD operations comprised in ZTFI, ZNVP and KDD Rules are supplemented by various *KDD regulations*. Regulations provide more detailed procedure, that should be considered by KDD, members, issuers or other persons with respect to:

- membership;
- maintenance of the central registry;
- settlement of stock exchange transactions;
- settlement of OTC-DVP trades;
- take-over bid procedures;
- other services provided by KDD.

The following KDD regulations are currently in force:

- Regulations of KDD on members;
- Regulations of KDD on settlement of stock exchange transactions;
- Regulations of KDD on central registry maintenance;
- Regulations of KDD on settlement of off-market transactions on the delivery versus payment basis;
- Regulations of KDD on ZPre-1 take-over bid procedures;
- Technical regulations of KDD.

In addition, KDD Tariff contains additional description of all services provided by KDD.

1. How can participants obtain a copy of the rules and procedures?

KDD Rules and their amendments should be published in the Official Gazette of the Republic of Slovenia. Current versions of KDD Rules, Regulations and Tariff should be published on KDD's web page.

2. Does other documentation provided to participants (e.g. user guides) have the same status as the rules and procedures?

Participants are provided with user guides and manuals which, however, do not have the same status as the Rules and Regulations. User guides and manuals contain technical details on the usage of the specific functionalities with regard to the KDD information system.

3. Describe the process for changing rules and procedures, including any need for regulatory approval.

KDD Rules and Regulations may be changed or amended if required either by the change of the market environment and legislation or as a consequence of development of KDD's system. Changes are drafted by KDD and discussed with participants.

Amendments to KDD Rules and Tariff

Amendments to KDD Rules and Tariff are drafted by the Management Board and adopted by a resolution of the Board of Directors of KDD. The Management Board shall submit its proposal to the members of KDD at least fifteen days before the day of the meeting of Board of Directors at which the Board of Directors is to decide on these amendments. The amendments become effective upon final approval of the Securities market agency.

Amendments to Regulations

Amendments to the Regulations are drafted by the Management Board and adopted by a resolution of the Board of Directors of KDD. The Management Board shall submit its proposal to the members of KDD at least fifteen days before the day of the meeting of Board of Directors at which the Board of Directors is to decide on these amendments. When amending Regulations no approval of SECURITIES MARKET AGENCY is required.

3.1 What authority is required, and how does this differ depending on the type of change involved?

Please see above.

3.2 How are participants notified of changes in rules and procedures?

Please see above.

3.3 Is there a procedure for participants or others to comment on proposed rule changes?

Each participant (i.e. KDD member) has the right to comment on proposed amendments. Participants usually exercise their right through their Participants Association, which comments or proposes different amendments to the Rules and Regulations before the drafted amendments are approved by the Board of Directors. They also hold a majority of votes in the KDD's Board of Directors.

B. Are the rules and procedures binding on the SSS as well as its participants? Under what conditions and on whose authority can rules and procedures be waived or suspended by the SSS?

The KDD Rules and Regulations are binding on both KDD and participants. They cannot be waived or overridden, except by the normal procedure of changing or amending as described above.

4 RELATIONSHIPS WITH PARTICIPANTS

In evaluating SSSs, it is essential that participants understand the nature of the relationships that the systems have with their participants. The different types of membership that are available as well as the requirements for admission as a participant should be understood. A knowledge of the account structure of the SSS is also important for an informed evaluation of the system. Participants should understand whether this structure allows or require the segregation of their customers' cash or securities in separate account or sub-accounts at the SSS.

This section addresses the issues as well as the procedures for and consequences of terminating participation in the SSS. Because of loss-sharing or other arrangements, termination of membership may not extinguish all obligations of participants with respect to the SSS. General limitation on SSS liability to participants are the subject of the final question in this section. These questions are obviously important in enabling participants to establish the magnitude of their exposures to different risks associated with the SSS.

Although these questions provide the basic framework of the relationship between participants and the SSS, many of the most important aspects of these relationships concern the resolution of failures to settle or events of default. Specific questions on these topics are discussed in Section VII below.

RELATIONSHIPS WITH PARTICIPANTS

A. Please describe the types of membership offered by the SSS?

The following types of SSS membership exist:

- Registry membership
- Settlement membership.

1. How do these types differ?

Registry membership is membership in the system of dematerialized securities accounts maintenance.

Pursuant to KDD Rules, under the *contract of accession to the Information system of dematerialised securities accounts maintenance*, KDD agrees to allow the registry member to use the information system of dematerialised securities accounts maintenance, in accordance with the requirements and in the manner set forth in KDD Rules and Regulations and, to the extent required, to:

- open and close accounts and sub accounts maintained by the registry member pursuant to KDD Rules or Regulations;
- enter orders, as the registry member may be authorized pursuant to KDD Rules or Regulations;
- access to information regarding accounts and sub accounts from the first paragraph above; and
- perform other acts with respect to maintenance of accounts or sub accounts from the first paragraph above, as may be permitted by the information system of dematerialised securities accounts maintenance,

provided that the registry member pays KDD, for the use of services, the compensation determined by the KDD Tariff.

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Settlement membership is membership in settlement system (i.e. settlement system for stock exchange transactions). Settlement membership is treated as an upgrade of Registry membership, as Settlement membership assumes also all features of Registry membership.

Pursuant to KDD Rules, under the contract on accession to the settlement system, KDD agrees to provide to the settlement member settlement services (in addition to the services available to registry members) provided that the settlement member pays KDD, for the use of services, the compensation determined by the KDD Tariff.

Settlement information system means the computer system maintained by KDD, and the procedures carried out by KDD to facilitate:

- the recording of data of rights and obligations of stock exchange members resulting from stock exchange transactions;
- the entry of data pertaining to an order to transfer dematerialised securities in settlement of a stock exchange transaction;
- the production, entry and execution of orders to transfer dematerialised securities in settlement of a stock exchange transaction; and
- the calculation of payment claims and liabilities resulting from stock exchange transactions.

Settlement services performed by KDD for settlement members' stock exchange transactions comprise:

- recording stock exchange trading report data;
- with respect to the settlement of payment obligations of settlement members:
 - calculating payment obligations; and
 - accepting and making payments with respect to fulfilment of these obligations;
- with respect to the settlement obligations of settlement members to transfer dematerialised securities:
 - ensuring the entry of orders to transfer dematerialised securities due, and of orders for allocation in the settlement information system,
 - verifying requirements for execution of orders from the previous item, and execution of these orders,
- in case of default on obligation by a settlement member:
 - performing buy-ins or sell-outs of securities; and
 - performing other actions required to fulfil obligations and exercise other settlement member's rights against certain settlement member, for a violation of its settlement obligations,
- with respect to the liability of settlement members to fulfil the obligations of other settlement members:
 - performing actions required to fulfil obligations resulting from such liability; and
 - management of the guarantee fund;
- communicating data through the settlement information system to settlement members regarding their rights and obligations resulting from their stock exchange transactions,
- performing other legal actions with respect to the settlement of stock exchange transactions, determined by KDD Rules and Regulations.

2. Within each membership category, are all participants subject to the same rules and procedures? Please describe important exceptions, including both differences in rules across participants and rationale for these differences.

Yes, all members in respective membership category are subject to the same rules and procedures. There are no exceptions.

B. Can participants establish accounts for their customers' assets that are segregated from their own asset accounts at the SSS?

Yes, members have to establish separate individual accounts for their customers' assets. Customers' accounts (and assets) are technically and legally completely segregated from members' accounts (and assets).

The concept of enabling for securities account operator (i.e. KDD member) and legal holder of securities to be different persons/entities (*the concept of securities account operator – holder separation*) has been adopted. Two major types of securities accounts that are maintained in the central registry reflect that possibility:

- **house accounts:** securities account operator (i.e. KDD member) is at the same time holder of the securities account and holder of securities registered thereon;
- **client accounts:** securities account operator (i.e. KDD member) is neither the holder of the securities account he operates nor the holder of securities registered thereon; the person who is the holder of the securities account and the holder of securities registered thereon is clearly indicated.

Therefore, a person (client) holding a securities account, although this account is maintained (operated) by KDD member (e.g. bank or brokerage house), is the holder of the securities registered on the securities account. As a holder of securities the person holding securities account is not howsoever affected by insolvency of KDD member or KDD. Consequently, no segregation or identifications procedures are necessary for the person holding securities account to retain continuous existence and enforceability of entitlements arising therefrom.

1. If so, is this accomplished through a single omnibus customer account or through a multiplicity of accounts and/or sub-accounts?

Types of dematerialised securities accounts available (i.e. types of holders' accounts) are defined by KDD Rules:

Holder's account is an account of dematerialised securities that comprises dematerialised securities:

- owned by a person; and
- single KDD member is authorised to enter holder's orders to dispose with securities registered on this account.

Third party rights and legal facts recorded in the central registry with respect to dematerialized securities are entered in the **sub account** maintained within the holder's account.

KDD Rules define different types of holder's accounts (e.g. house account, client account, portfolio account, fiduciary account etc.). Regardless of the holder's account type, the holder of the securities account is at the same time the holder of dematerialized securities registered on this account.

2. Is the segregation optional or compulsory?

The segregation is compulsory. Please see *The concept of securities account operator – holder separation* point B above.

3. Does the fact that a sub-account at the SSS bears the name of a third party give any rights to that third party as a participant under the rules of the system?

Please see point B-1 above.

C. Please describe participant requirements for each type of membership.

Participation (i.e. membership) in KDD is regulated by ZTFI. In addition, more precise access and exit criteria for KDD membership are set forth by the KDD Rules, KDD Regulations on members and KDD Technical Regulations. They are published on KDD web page.

Two types of membership exist:

- **Registry membership:** Registry member is an entity entitled by KDD to use the information system of dematerialised securities accounts maintenance.
- **Settlement membership:** Settlement member is an entity entitled by KDD to use the information system of dematerialised securities accounts maintenance and settlement information system (for settlement of stock exchange trades) operated by KDD.

Eligible person may become:

- registry member, or
- settlement member.

KDD shall notify of the admission of every new member:

- stock exchange,
- Securities market agency,
- Bank of Slovenia (if a member is a bank), and
- other KDD members.

Eligible person applying for registry or settlement membership may apply either for **limited** or **unlimited membership** subtype.

By applying for unlimited membership, KDD shall provide to a member access to information system of central registry to a full extent necessary for operating his house account(s) and his clients' account(s) and performance of stock exchange trades settlement. By applying for limited membership, the access to information system of central registry shall be restricted to certain specific securities accounts.

Registry membership:

Pursuant to KDD Rules, under the *contract of accession to the system of dematerialized securities accounts maintenance*, KDD agrees to allow registry member to use the information system of dematerialized securities accounts maintenance, in accordance with the requirements and in the manner set forth in these rules and regulations and, to the extent required, to:

- open and close accounts and sub accounts maintained by the registry member pursuant to KDD Rules or Regulations;
- enter orders, as the registry member may be authorized pursuant to KDD Rules or Regulations;
- access to information regarding accounts and sub accounts from the first paragraph above; and

Disclosure framework for securities settlement systems

- perform other acts with respect to maintenance of accounts or sub accounts from the first paragraph above, as may be permitted by the information system of dematerialized securities accounts maintenance,

provided the registry member pays KDD, for the use of its services, the compensation determined by KDD Tariff.

In addition, registry members have to fulfil the following requirements (pursuant to Regulations of KDD on members):

- Staff requirements for the use of information system of central registry,
- Organizational requirements for the use of information system of central registry,
- Technical requirements for the use of information system of dematerialized securities accounts maintenance (set forth in KDD technical regulations).

Settlement membership:

Pursuant to KDD Rules, under the *contract of accession to the settlement system*, KDD agrees to provide settlement services to settlement member, provided the registry member pays KDD for the use of its services the compensation determined by KDD Tariff. Becoming a settlement member entails certain rights and obligations in relation to KDD and other settlement members (including contribution payments to the Guarantee fund).

In addition, settlement members have to fulfil the following requirements (pursuant to Regulations of KDD on members):

- Staffing requirements for the use of information system of central registry,
- Organizational requirements for the use of information system of central registry,
- Technical requirements for the use of information system of dematerialized securities accounts maintenance (set forth in KDD technical regulations),
- Solvency requirements for the use of settlement system.

1. Are participants required to be domiciled or resident in a particular jurisdiction?

No, potential participants from member states are not required to be domiciled or have status of resident in the Republic of Slovenia. The non-EU domiciled participants must however open a subsidiary in the Republic of Slovenia.

2. Are participants required to be subject to a supervisory regime? If so, please describe.

Yes, KDD supervises registry members in order to control their performance of management of dematerialised securities accounts according to KDD Rules and Regulations by verifying the requirements for execution of orders entered in the central registry by respective registry member.

KDD supervises the solvency of settlement members in order to manage risks of eventual defaults in obligations arising from stock exchange transactions, by verifying whether settlement members timely fulfil their payment obligations to KDD and to other settlement members in the settlement system. KDD may request from settlement member to submit additional evidence of its solvency.

If Securities market agency or the Bank of Slovenia temporarily prohibits a member to perform services with respect to securities, KDD shall disconnect a member from the information system of dematerialised securities accounts maintenance or from settlement information system for the duration of such prohibition.

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3. Are participants required to hold an equity stake in the SSS?

No, participants are not required to hold an equity stake in KDD.

4. Are there financial economic, personal or other requirements? If so, please describe.

Please see point C above.

D. Does the SSS engage in oversight of its participants to ensure that their actions are in accordance with its rules and procedures? If so, please describe.

Please see Point C-2 above.

E. Under what conditions can participants terminate their membership in the SSS? Does this mark the end of all liabilities of the participant? If not, please describe what liabilities could remain?

Membership in KDD can be terminated either by cancellation (on member's initiative) or exclusion (on KDD's or other authority's initiative).

KDD shall notify of the cancellation or exclusion of a member:

- the stock exchange;
- Securities market agency;
- the Bank of Slovenia (if the member is a bank);
- other KDD members.

Cancellation of membership

Cancellation of a registry membership: A registry member may cancel its membership in the system of dematerialised securities accounts maintenance by submitting a cancellation statement to KDD in writing. The cancellation statement becomes effective on the first day of the month, following the month in which the registry member complies with his obligations described below.

Cancellation of a settlement membership: A settlement member may cancel its membership in the settlement system on two months' notice. A settlement member cancels such membership with a cancellation statement submitted to KDD in writing. The cancellation becomes effective on the first day after two months notice period. Notice period starts on the first day of the month, following the month when a member submits cancellation statement.

Registry member obligations on cancellation (or exclusion): A registry member who cancels his membership or who is excluded from the system of dematerialised securities accounts maintenance shall:

- ensure that holders, whose accounts it maintains, transfer the dematerialised securities registered on these accounts to the credit of the accounts maintained by other registry members or by KDD;
- transfer dematerialised securities from its house accounts to the credit of the accounts maintained by other registry members; and
- meet the requirements for closing of all accounts of dematerialised securities it maintains.

Termination of settlement membership has no legal effect on member's obligations arising from stock exchange transactions executed or to be settled by such member (prior to termination). KDD

Disclosure framework for securities settlement systems

has a right to set off a claim against the settlement member that KDD enforces either to the benefit of the guarantee fund or to the benefit of another respective settlement member or to its own benefit, against the settlement member's claim to payment (return) of its contribution paid to the guarantee fund.

Provisions of KDD Rules and Regulations ensure orderly exit of a member without endangering the settlement of claims and liabilities in relation to the other members.

F. Under what conditions can the SSS terminate a participant's membership in the SSS?

Exclusion of a member

Pursuant to KDD Rules, KDD shall exclude a member whose license for performing investment services and transactions is cancelled or for any reason loses its status of eligible person that can apply for KDD membership (see membership eligibility requirements above).

Pursuant to KDD Rules, KDD may exclude a member, if the member:

- does not pay KDD the compensation for use of its services within eight days of receiving the reminder for payment from KDD;
- is late in paying compensation for its use of KDD services, more than twice within six months,
- no longer fulfils technical, staffing, or other requirements under KDD Rules or Regulations, or with respect to its use of information system of dematerialized securities accounts maintenance, or for its use of the settlement information system, and does not remedy this violation within eight days after receiving from KDD a notice specifying the violation;
- does not fulfil such requirements mentioned in the preceding point more than twice within six months; or
- for any other reason for exclusion set forth with respect to a particular type of membership.

Additional reasons for exclusion of settlement member: KDD shall exclude a settlement member from the settlement system, if the member:

- is excluded from the system of dematerialised securities accounts maintenance;
- violates twice, within three years:
 - an obligation to the settlement system which resulted in fulfilment of such obligation from the assets of the Guarantee fund; or
 - an obligation to contribute to the Guarantee fund;
- violates:
 - an obligation to the settlement system, and whose value exceeds his share in the guarantee fund determined by KDD Regulations, if such violation resulted in using the assets of the Guarantee fund; or
 - an obligation to contribute to the Guarantee fund an amount exceeding the share of Guarantee fund determined by KDD Regulations.
- does not fulfil solvency requirements and does not comply with them within the ensuing six months.

G. Please describe the scope of the SSS's liability to participants, including the standard of liability, the force majeure standard and limitation to the scope of liability of the SSS. Where are these liabilities and their limitations set out?

Pursuant to ZTFI it is an obligation of KDD to establish and exercise solid and reliable management system that includes efficient processes of risk determining, measuring, assessing as well as risk

Disclosure framework for securities settlement systems

management and overseeing of all risks KDD is exposed to or could be exposed to when performing its business.

However, if an unlikely event of default, negligence or fraud on the part of the KDD should nonetheless occur, strict liability is envisaged both by general rules of Code of Obligations governing liability for damages as well as by special rules of ZNVP. The liability of KDD for default, negligence or fraud covers both actual damages and the loss of profit caused by such misconduct. The injured party (e.g. holder of securities) is entitled to full compensation.

5 RELATIONSHIPS WITH OTHER SSSS AND COMMERCIAL INTERMEDIARIES

Many SSSs have relationships with intermediaries who perform critical tasks for the SSS and indirectly, therefore, for the system's participants and their customers. In particular, relationships or linkages between SSSs may be important for an understanding of the implications of settlement arrangements. For example, in those instances where the linkage includes using another SSS or a commercial intermediary as a securities sub-custodian, disclosure of information concerning the linkage would be essential for participants to fully evaluate the associated risks. The appraisal of risks may differ depending on whether the linkage allows only free deliveries or whether cash accounts at the two SSSs are also involved. The latter types of linkage deserve particular attention to ascertain whether they increase the potential for settlement disruptions to spread quickly between different systems.

Because it is the SSS and not its participants that negotiates and concludes the agreements with these third parties, it is important for participants to be fully advised on the relevant aspects of the system's various intermediary relationships, including the standards used by the SSS in the selection and monitoring of intermediaries, the functions that the intermediaries perform and any specific risk management mechanism in place specifically to protect against the risks posed by these relationships. It is also important to identify instances in which the SSS advances funds or securities on behalf of third parties or intermediaries, as these actions can pose risks to the SSS and its participants.

RELATIONSHIPS WITH OTHER SSSs AND COMMERCIAL INTERMEDIARIES

A. Does the SSS maintain linkages or other relationships with other SSSs?

Yes, the following links between KDD (as an issuer CSD) and other SSS are established:

- unilateral direct operated link to ICSD Clearstream Banking Luxembourg (operated by KDD member Nova Ljubljanska banka d.d.),
- unilateral relayed link to CSD Clearstream Baking Frankfurt (via CBL),
- unilateral link to ICSD Euroclear Banking (operated by KDD member UniCredit banka Slovenija d.d.),
- unilateral direct operated link to KDPW (operated by KDD member Nova Ljubljanska banka d.d.).

1. Please identify each of the other SSSs used and type of securities transferred via the linkages?

There are no restrictions regarding the types of securities registered in central registry that can be transferred to mentioned ICSDs via established links.

1.1 What is the name and location of the other SSS?

Please see Point A above.

1.2 What securities are eligible for transfer via the linkage to the other SSS?

Please see Point A-1 above.

1.3 Are transfers of securities via the linkage to the other SSS limited to only those that are free of payment or are transfers against payment also made via the linkage to the other SSS? If against payment, please describe the timing of the transfers and the corresponding payments.

Links support FoP and DvP settlement. Settlement procedures are in detail explained in Chapter 6.

1.4 Does the other SSS provide custody services to the SSS and, if so, who bears any credit or custody risks?

Since links are one way only (i.e. KDD only provides services to other (I)CSD's and does not use services of other (I)CSD's), they are governed by Slovenian law. Consequently, all the safeguards, that are in place in Slovenian law to eliminate or minimize potential risks, stand also for KDD's links with mentioned (I)CSDs as well. As far as custody risk in particular is concerned, it is eliminated by means described below:

Due to the concept of “securities account operator – holder separation”, securities registered to the securities account of a holder, different from account operator (i.e. KDD member), do not form a part of account operator's bankruptcy estate. Even in case that particular person does not exercise the legal option to have the securities registered in their account (and therefore being the holder of securities) and rather considers the option of having the securities registered to fiduciary securities account held by the same KDD member that operates the very account, they will still enjoy legal protection. Namely, as provided by ZTFI, securities registered on the fiduciary securities account are deemed – as far as creditors of the account holder (i.e. account operator) are concerned – as the assets of beneficiary and not of the account holder (i.e. account operator). It is explicitly stated that in case of bankruptcy of the account holder (i.e. account operator) securities, registered on fiduciary accounts, held by such account holder, do not form a part of its bankruptcy estate. Therefore the *custody risk is eliminated*.

Both security settlement systems operated by KDD that provide for securities and cash leg settlement of transactions (i.e. system for settlement of stock exchange transactions and system for DVP settlement of off-market transactions) are operated on DVP basis. Therefore the **principal credit risk** (risk of the non-defaulting party of loss of the full value of securities or monetary funds that it has transferred to the defaulting counterparty) **is eliminated**.

KDD is by law prohibited to perform services or functions where it would act as a principal, since it does not grant any cash credits nor provide any securities loans. To avoid any exposure of KDD to credit risk (pursuant to provisions of ZTFI):

- KDD may not act as Central counterparty, and
- KDD, in relation to settlement of stock exchange (or any other) transactions with securities, or in relation to payment obligations derived from the rights embodied in the securities (dividends, interests), may not expose itself by assuming any payment obligations of settlement members, issuers or any other persons/entities, or engage in any other activities whereby it would assume credit risk.

B. Does the SSS use securities custodians and or commercial cash correspondents? Please identify the custodians or cash correspondents used and the duties that each perform?

Since KDD does not provide all custody services necessary for operation of links (KDD has no banking license and consequently cannot serve all needs of ICSDs' clients), some custody services (along with operation of corresponding fiduciary accounts) are provided by custody banks chosen by each ICSD respectively. Exact scope of services provided by each custody bank in relation to servicing the link to ICSD is subject to their bilateral Service Level Agreement.

C. Please describe the standards used in approving or reviewing relationships with other SSSs, custodian or cash correspondents, including any financial or operational requirements or the presence of insurance or public supervision.

Since links are one way only (i.e. KDD does not use services of other depository), they are governed by Slovenian law. Consequently, all the safeguards that are in place in Slovenian law to eliminate or minimize risks stand also for KDD's links with mentioned (I)CSDs.

D. Does the SSS advance funds or securities to or on behalf of other intermediaries such as issuing and paying agents? If so, please identify the circumstances in which such exposure could arise.

KDD does not have a banking license and could therefore perform only limited set of functions of paying and issuing agent itself (from perspective of its status as depository, registrar and securities settlement system). However, funds/securities of issuers/beneficiaries are not effected by potential insolvency of KDD. This also holds for insolvencies of other depositories or SSS in case that links between them and KDD are established.

E. Please describe measures in place to protect the SSS and its members against the failure of other SSSs or commercial intermediaries to meet obligations to the SSS, including risk controls, collateral or alternative sources of funds and securities.

Pursuant to ZNVP, a person on whose account in central registry dematerialized securities are registered (i.e. securities held in the SSS), is a legal holder of those securities. This holds regardless of the account type.

Rights of holder of dematerialized securities (i.e. rights of holder of a dematerialized securities account on which the securities are registered) constitute:

- the rights arising out of the securities against the issuer, and
- the right to dispose with dematerialized securities (i.e. to transfer dematerialized securities to another person or to enable a third person to acquire a third party right on dematerialized securities).

Rights of a holder of dematerialized securities (i.e. legal owner) are directly enforceable against the issuer.

Neither the insolvency of KDD member that maintains (operates) dematerialized securities accounts, nor the insolvency of KDD that maintains (operates) the central registry (i.e. SSS operator), has any legal effect for the rights of holders of securities. Dematerialized securities registered on dematerialized securities accounts of clients of insolvent KDD member, which maintains/operates those accounts, do not form a part of KDD member's bankruptcy estate. The same applies in the case of insolvency of KDD.

No segregations or identification procedures are necessary for the existence or enforceability of holder's rights (entitlements) to dematerialized securities in the case of insolvency of KDD member or KDD. This also holds for insolvencies of other depositories or SSS in case that links between them and KDD are established.

6 SECURITIES TRANSFERS, FUNDS TRANSFERS AND LINKAGES BETWEEN TRANSFERS

At the heart of the operations of SSSs are the transfers of securities and fund that actually comprise the settlement process. The questions in this section begin by focusing on the process, if any, for matching settlement instructions prior to beginning the settlement process itself. In some markets, matched settlement instructions are binding, which may impose additional obligations on participants that are important for them to understand.

This section next considers issues raised by the practice of securities registration. Because the laws of different countries vary widely in this regard, this disclosure framework has not been designed to substitute for the legal analysis of the implications of registration, for example the issue of the nature of the title to securities that is transferred in the SSS if the system itself is not also the registrar. The questions are instead focused on the circumstances in which the SSS itself becomes involved in the registration process, as well as the risks that may arise if participants fail while securities are in the process of being re-registered in the buyer's name. In particular, it is important to understand whether the rules and procedures of the SSS would require transactions to be unwound in such an event.

The mechanics of securities and funds transfers are then addressed, including the issue of where cash transfers associated with securities transfers at the SSS take place. These questions also address the circumstances under which the SSS extends credit to participants as an aspect providing funds transfer capability at the SSS. It is clearly important for participants to understand what types of cash account are offered at the SSS and on whom they take a risk with respect to cash deposits, as well as whether the SSS itself bears credit risk in conjunction with these accounts.

The questions then explore the timing of processing within the SSS, whether the SSS is a DVP system, and what type of DVP model, if any, has been adopted by the SSS. DVP is a mechanism which ensures that final delivery occurs if and only if final payment occurs. which eliminates principal risk and contributes to reduction in liquidity risk.

The issues which arise in the practical implementation of DVP were outlined in the DVP Report referred to in the Introduction, and mainly concern the finality of the securities transfers and the funds transfers which together constitute the DVP settlement. Transfers are final if they are both irrevocable and unconditional. A transfer is irrevocable when the parties to it can no longer revoke their instructions, and it becomes unconditional when there are no longer any circumstances that could cause the SSS to unwind it. If transfers are provisional at the time of processing, even if DVP is achieved, the risk remains that transfers may have to be unwound later if finality cannot be achieved.

If not properly recognized and controlled, this "finality risk" could have systemic effects. Member of SSSs are often provided with immediate availability of securities received, even if the transfer is not final. If these members sell the securities again, or make them available to custodial clients, and the original transfer is subsequently unwound, additional transfers by the member or the member's clients may also have to be unwound, spreading the impact of the unwind to unrelated parties. It could also ultimately lead to losses to be shared among participants. For these reason, the questions below attempt to clarify precisely the circumstances under which transfer become final.

The questions also address the provision of settlement guarantees by the SSS. If guarantees exist, it is necessary for participants to understand the events that trigger the guarantee as well as the coverage that is provided by the guarantee, including the liability of the SSS with respect to the guarantee.

SECURITIES TRANSFERS, FUND TRANSFERS, AND LINKAGES BETWEEN TRANSFERS

A. Please discuss whether and how settlement instructions are matched between participants prior to processing by the SSS.

Ljubljana Stock Exchange transactions

KDD members, acting upon their own or their clients' instructions, enter bids and asks in the stock exchange trading system, which automatically matches the bids with asks. This means that KDD receives already matched and locked-in trades and therefore does not perform matching service for the organized market. Matched instructions, which are entered on-line in the KDD's settlement information system, become binding and irreversible by 4.30 p.m. (T+0).

Off-market transactions (OTC-DVP)

KDD provides a trade matching service for off-market (OTC-DVP) trades through its information system of dematerialised securities accounts maintenance. This requires one party (i.e. KDD member) to enter and other party to confirm entered trade details, before the settlement is eligible for execution. The seller's registry member is authorized for the entry of order (i.e. OTC-DVP transfer order). The order should be confirmed by the buyer's registry member in the KDD information system of dematerialised securities accounts maintenance. After being confirmed (matched), the status of securities to be transferred is changed from 'freely-available' to 'blocked.' By the end of the day (3.30 p.m. at the latest), the buyer must ensure the transfer of the total purchase price to KDD's cash clearing account in the TARGET2 RTGS payment system. Following the receipt of the total purchase price, KDD transfers amount to the seller's bank, unblocks the securities on the end seller's account and transfers the securities to the end buyer's account.

1. Is matching required for all transactions without exceptions?

Matching is required for all stock exchange transactions and OTC-DVP transactions. Please see above.

2. What procedure is used when instructions do not match?

Stock exchange transactions

When order (bids and asks) do not match and remain unmatched by the end of the trading period, they are automatically removed from the stock exchange trading system. Open orders remain entered in the system.

Off-market transactions (OTC-DVP)

KDD rejects the execution of the confirmed (i.e. matched) order in the information system of dematerialised securities accounts maintenance, if the buyer, until 3.30 p.m. on the day of entry and confirmation of the order, does not deposit the purchase price. KDD shall electronically notify the seller's registry member on the rejection of execution of the confirmed order through the information system of dematerialised securities accounts maintenance. If KDD rejects the execution of the confirmed order, it deletes the entered order from the information system of dematerialised securities accounts maintenance.

If the buyer's member does not confirm seller's member order till 3.30 p.m. at the latest, matching does not occur and KDD deletes the entered order from the information system of dematerialised securities accounts maintenance.

3. Are matched settlement instructions binding on participants?

Disclosure framework for securities settlement systems

Stock exchange transactions

Data on stock exchange trades (matching is performed by stock exchange), concluded on a respective trading day, are finally entered by KDD in the settlement information system upon receipt of stock exchange's confirmation that all transactions are final, except those of whose annulment the stock exchange notified KDD. If KDD does not receive an explicit stock exchange's confirmation until 4.30 p.m. on a respective trading day, it is considered that all transactions whose data were entered in the settlement information system are irreversible and binding on participants, except those deleted from the settlement information system. If a respective stock exchange transaction executed on a respective trading day was annulled pursuant to the rules of stock exchange, KDD deletes data on this transaction from the settlement information system immediately upon receipt of notification of stock exchange on annulment of this transaction.

This means that matched stock exchange trades are non-binding on trading day (T+0) until the moment KDD receives confirmation from stock exchange that all transactions whose data were entered in the settlement information system are final (and binding on participants), except those data that were deleted from the settlement information system. After that moment matched trades are binding and irreversible for participants.

OTC-DVP transactions

KDD provides OTC-DVP settlement mechanism to settle operations with intraday finality between 8:00 a.m. and 3:30 p.m. Matched OTC-DVP transactions are non-binding on participants.

The seller's registry member is authorized for the entry of order (i.e. OTC-DVP transfer order). The order is confirmed by the buyer's registry member in the KDD information system of dematerialised securities accounts maintenance. After being confirmed (matched), the status of securities to be transferred is changed from 'freely-available' to 'blocked.' At the same time, a reference number (to be used in field 70 in the SWIFT msg. type MT 103+) is assigned to the transactions for the purpose of funds transfer.

The buyer's registry member rejects the confirmation of order for simultaneous fulfilment with the entry of data on rejection of confirmation of order in the information system of dematerialised securities accounts maintenance. If the buyer's registry member rejects the confirmation of order, it shall immediately electronically notify the seller's registry member on the reasons for rejection of confirmation of order through the information system of dematerialised securities accounts maintenance. It is considered that the buyer's registry member rejected the confirmation of order, if it does not confirm the order until 3.30 p.m. on the day the order was entered. If the buyer's registry member rejects the confirmation of order, KDD deletes the entered order from the information system of dematerialised securities accounts maintenance.

If on the basis of a respective order for payment, a monetary amount deposited is smaller or larger than the exact amount of purchase price, indicated in the order, or if in the order for payment, an incorrect reference number is indicated, KDD returns the remitted amount by crediting the account to whose debit the amount was paid. In case from the precedent sentence, it is considered that the buyer did not fulfil the obligation to deposit the purchase price.

3.1 If so, please describe the consequences of failure by participants to meet obligations (e.g. forced settlement, penalties, short positions).

Default procedures apply to stock exchange transactions only. Please see Chapter 7.

3.2 Please describe whether this is a feature of the SSS's rules and procedures or of national law or regulations.

Disclosure framework for securities settlement systems

Default procedures concerning settlement of stock exchange transactions are regulated in KDD Rules and Regulations.

3.3 Please provide a time line indicating the points at which matched instructions become binding, as well as any pre-matching process that takes place.

Please see above.

B. Are securities transferred within the SSS registered?

Yes, securities transferred within KDD's system are registered.

1. Who is the registrar?

Central registrar is KDD.

2. Is it normal practice to register securities in the name of the SSS (or its nominee) or in the name of the beneficial owner? Are there instances in which securities housed within the SSS are registered to neither the SSS (or its nominee) nor the beneficial owner?

Pursuant to ZNVP, a person on whose account in central registry dematerialized securities are registered (i.e. securities held in the SSS), is a legal holder of those securities. This holds regardless of the account type.

Rights of holder of dematerialized securities (i.e. rights of holder of a dematerialized securities account on which the securities are registered) constitute:

- the rights arising out of the securities against the issuer, and
- the right to dispose with dematerialized securities (i.e. to transfer dematerialized securities to another person or to enable a third person to acquire a third party right on dematerialized securities).

Rights of a holder of dematerialized securities (i.e. legal owner) are directly enforceable against the issuer.

The concept of enabling for securities account operator (i.e. KDD member) and legal holder of securities to be persons different from each other (the concept of securities account operator – holder separation) has been adopted. Two major types of securities accounts that are maintained in the central registry reflect that possibility:

- house accounts - securities account operator – KDD member – is at the same time holder of the securities account and holder of securities registered thereon,
- client accounts - securities account operator is neither the holder of the securities account he operates nor the holder of securities registered thereon; the person who is the holder of the securities account and the holder of securities registered thereon is clearly indicated.

Therefore, a person (client) holding a securities account, although this account is maintained (operated) by KDD member (e.g. bank or brokerage house), is the holder of the securities registered on the securities account. As a holder of securities the person holding securities account is not howsoever affected by insolvency of KDD member, KDD or linked SSS. Consequently, no segregation or identification procedures are necessary for the person holding securities account to retain continuous existence and enforceability of entitlements arising therefrom.

3. If the SSS offers custodial services, will it hold securities registered in the name of the beneficial owner?

KDD does not act as a custodian and does not hold securities for beneficial owners.

4. Under what circumstances does the SSS initiate registration of securities in the buyer's name?

Pursuant to ZNVP on the issue of dematerialised securities, the issuer shall issue the KDD an order to issue dematerialised securities on behalf and for the account of the issuer by entering in the central register the information about the essential components of dematerialised securities and to credit them to the accounts of their holders who have subscribed and paid such securities (“issuing order”).

Dematerialised security shall consist of the following essential components entered in the central registry (applies to all types of securities):

- type (code) of security;
- issuer identification data;
- “bearer” or “registered” security type;
- total volume of securities issued (and entered in central registry);
- total nominal value of securities issued and entered in central registry (or number of no-par value shares);
- date of entry of securities in central registry.

KDD performs the following steps in the issuance process for dematerialised securities:

step 1: Entry of dematerialised securities issued in the central registry: KDD records in the central registry the dematerialised securities being issued by entering in the central registry:

- the uniform identification of such securities (ISIN code) and their designation code (i.e. a code by which securities are registered on the accounts of the holders),
- their essential components.

step 2: Crediting the control account with issue volume of dematerialised securities: KDD registers the entire volume of dematerialised securities being issued on the control account opened for particular issue. A control account is a type of auxiliary account, maintained in the central registry only for purposes of eliminating risks of possible mistakes in securities issuance process.

step 3: Transfer of dematerialised securities by debiting control account and crediting of holders' accounts: KDD enters and executes orders to transfer dematerialised securities being issued by debiting the control account and crediting holders' accounts which the issuer states in its issuing order, as those persons are entitled to the appropriate number of such dematerialised securities being issued.

Upon completion of step 3 (upon transfer of dematerialised securities crediting holders' accounts) the securities are (legally) issued. At that moment the rights of holders' of the securities (embodied in the security) and the obligations of issuer (embodied in the security) arise.

5. How long does the registration process typically take? Are all participants notified when registration is complete?

KDD shall decide on the issue, annulment or replacement of securities in the following time limits:

- if the issuer's order refers to the issue of dematerialised securities, except the issue of securities on the basis of increase of issuer's capital stock: within eight days from receipt of the issuer's order;

Disclosure framework for securities settlement systems

- if the order refers to the issue and annulment of securities due to execution of merger or division with respect to which KDD performs the representative's services: within fifteen days from receipt of the notification on the entry of merger or division in the register of companies,
- in other cases: within fifteen days from receipt of the issuer's order.

All the SSS members are notified on corporate actions of issuers. In addition, such announcements are published on KDD's home page.

6. Can securities be transferred within the SSS before registration in the buyer's name is complete? If so, do the rules and procedures of the SSS provide for an unwind or reversal of such transfers in case of bankruptcy or other events which result in the buyer's name not being entered on the register?

No, there is no case in which securities could be transferred within KDD's accounts, before registration in the buyer's name is completed.

C. Please describe how securities transfers are processed within the SSS.

1. Please indicate whether the transfers are processed as debits and credits to members' account/sub-accounts?

Securities transfers within KDD are processed directly as debits and credits to the securities accounts of legal owners.

2. On a continuous (real-time) basis, or in one or more batches?

Stock exchange transactions

Securities transfers concerning stock exchange transactions occur at the end of the day T+2 1.00 p.m. in a single (interday) batch.

OTC-FOP

Entry and execution of transfer order are processed in real time. OTC-FOP facility is available from 7.00 a.m. to 6.00 p.m. (T+0 real time intraday settlement).

OTC-DVP

The OTC-DVP mechanism operates on a principle that securities subject to respective transaction became "blocked" immediately after buy and sell instructions are matched. Final delivery of securities to the buyer occurs conditionally upon delivery of funds to the KDD's clearing and settlement account opened with TARGET2. Received funds are then transferred to the account of seller's bank. When the seller's bank confirms receipt of funds, KDD unblocks securities concerned and transfers them to the buyer's securities account.

Facility is available from 8.00 a.m. to 3.30 p.m. (T+0 real time intraday settlement).

3. If continuous, during what hours does the processing occur? If in batches, at what time or times is the processing initiated and completed?

Please see above.

4. Do securities settlements occur daily? Please identify securities for which settlement occurs only on specific days of the week or month.

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Please see above.

The use of certain settlement mechanism does not depend on security type. All securities eligible for settlement at KDD are subject to the same settlement procedures.

D. Please describe whether final funds transfers in conjunction with the SSS are made as debits and credits to balances held at the SSS, at one or more commercial banks, at the central bank, or via some other method.

Final funds transfers from stock exchange transactions on T+2 are made to net-to-receive KDD settlement members.

Final funds transfers from OTC-DVP transactions are made to sellers' cash accounts (as specified in instruction entered into KDD's information system of dematerialised securities accounts maintenance).

In both cases funds are transferred from KDD's clearing and settlement account opened with TARGET2.

1. Does the SSS maintain cash accounts for its participants? Are these accounts equivalent to deposit accounts at a commercial or central bank or do they serve only as cash memorandum accounts?

No, KDD does not maintain cash accounts for its participants.

2. On what entity (SSS or other) does the participant bear cash deposit risk?

KDD does not bear cash deposit risk since it does not maintain cash accounts for its participants. The only theoretical cash deposit risk exposure is related to the funds of Guarantee fund and liquidity reserve. However, those funds are held with the Bank of Slovenia in order to achieve ultimate security and immediate accessibility of funds if needed.

3. Under what circumstances does the SSS provide credit extensions or advances of funds to its participants and thereby expose itself to credit risk?

KDD does not perform services or functions where it would act as a principal or bear credit risk (pursuant to ZTFI).

4. How long can such credit extension last? How long do they typically last?

Not applicable. Please see above.

E. Is the SSS a DVP system? Describe the DVP model used according to the models outlined in the DVP REPORT. Please also provide a diagram indicating the timing of events in the processing of securities and funds transfers in the SSS. Where the SSS provides more than one alternative for settlement processing, please provide a response for each alternative and indicate the relative importance of each alternative.

a. Stock exchange transactions

KDD operates a BIS DVP Model 2 (netting on the cash side, gross securities transfers) settlement system for all transactions conducted on the Ljubljana Stock Exchange.

Disclosure framework for securities settlement systems

For trades concluded on respective trading day (T+0), seller's KDD member has to ensure sufficient quantity of securities on end seller's securities account and buyer's KDD member has to transfer funds (exact value calculated by KDD) to KDD clearing and settlement account (opened with the TARGET2) both till 11 a.m. T+2 at the latest. Process of final transfer of funds and securities starts at 1.00 p.m. on T+2. At this point the finality is achieved.

b. Off-market transactions (OTC-DVP)

KDD operates a BIS DVP Model 1 settlement mechanism for OTC-DVP transactions, where the securities and funds are settled on a gross basis. For details please see explanation above. DVP system is used in takeover procedures as well.

1. Are funds transfers and securities transfers processed within the same system or in different systems? If different how they are linked?

Securities transfers are processed within the KDD's central registry, cash transfers on the other hand are processed within the TARGET2 RTGS payment system. National system component of RTGS TARGET2 payment system (i.e. TARGET2-Slovenija) is operated/managed by the Bank of Slovenia. Both systems are linked (i.e. interfaced system). In addition, according to the agreement between KDD and the Bank of Slovenia, KDD sends to the Bank of Slovenia the list of clearing member's obligations and claims, deriving from the Ljubljana Stock Exchange transactions. Since the above mentioned systems are linked, it is made possible that the final transfer of securities and the final transfer of net cash positions occur simultaneously on T+2.

1.1 Please describe whether each securities transfer is linked to a specific funds transfer on a trade by trade basis or on a net basis or via some other method.

Stock exchange transactions

Cash side – multilateral netting;
Securities transfer side – trade for trade (gross basis).

OTC-DVP transactions

Cash side – trade for trade (gross basis);
Securities transfer side – trade for trade (gross basis).

1.2 Does the SSS split large transactions into multiple transactions or require the participants to do so?

No, KDD does not split large transactions and does not require its members to do so.

2. When do securities and fund transfers become final?

Stock exchange transactions

In the case of the transactions conducted on the Ljubljana Stock Exchange, the securities and cash become irrevocably committed to settlement on T+0 at 4.30 p.m. The finality of settlement is achieved for both securities and cash on T+2 at 1 p.m.

OTC-FOP transactions

Transfer order becomes irrevocable upon entry in central registry. The precise moment of entry of a transfer order in central registry is defined by KDD's (technical) regulations as the moment when

Disclosure framework for securities settlement systems

the computer application “order engine” running on a server operated by KDD receives electronic file (in XML format) containing transfer order data.

Transfer of dematerialised securities from (debiting) transferor’s dematerialised securities’ account to (crediting) transferee’s dematerialised securities’ account becomes final upon execution of transfer in central registry.

Entry and execution of transfer order are processed in real time. Facility is available from 7.00 a.m. to 6.00 p.m.

OTC-DVP transactions

The OTC-DVP mechanism operates on a principle that securities subject to respective transaction became “blocked” immediately after buy and sell instructions being matched. Final delivery of securities to the buyer occurs conditionally upon delivery of funds to the KDD’s clearing and settlement account opened with TARGET2. Received funds are then transferred by KDD to the account of seller’s bank. When the seller’s bank confirms receipt of funds, KDD unblocks securities concerned and transfers them to the buyer’s securities account. At this point, the finality is achieved. T+0 real time settlement applies for OTC-DVP transactions. Facility is available from 8.00 a.m. to 3.30 p.m.

2.1 At what time do securities transfers become final? After what event or events?

Please see above.

2.2 At what time do funds transfers become final? After what event or events? Does this timing allow for same-day retransfer of funds received in exchange for securities?

Please see above.

As explained above for stock exchange transactions, until 11:00 a.m. T+2, the cash transfer orders are executed by the Bank of Slovenia and funds are paid into the KDD clearing and settlement account opened in TARGET2 RTGS payment system; thus the funds become inaccessible to the KDD members. As until 1:00 p.m. on T+2, KDD transfers the received funds from its clearing and settlement account opened in TARGET2 RTGS payment system to the clearing accounts of the net-to-receive members, it is possible for them to retransfer received funds to their clients the same day.

2.3 If final delivery of securities precedes the final transfers of funds, can participants dispose freely of such securities prior to funds finality? If so, what actions will be taken if funds are not received?

Not applicable.

2.4 If final transfers of funds precede the final transfer of securities, can participants dispose freely of such funds prior to securities finality? If so, what actions will be taken if securities are not received?

Not applicable.

2.5 Does the timing of finality differ depending on the type of security transferred or the currency in which payment is to be made? Please describe.

The timing of finality does not differ with respect to different types of securities, nor does it differ with respect to different currencies. All payments have to be denominated exclusively in Euro.

3. Please discuss whether participants are notified of securities or funds transferred or the currency in which payment is to be made? Please describe.

Participants are promptly informed of their securities and funds transfers, and pending transactions on real time basis (on-line through the information system).

F. Does the SSS itself guarantee funds or securities transfers?

KDD does not perform services or functions where it would act as a principal, since it does not grant any cash credits nor provide any securities loans. Pursuant to ZTFI:

- KDD may not act as Central counterparty, and
- KDD, in relation to settlement of stock exchange (or any other) transactions with securities, or in relation to payment obligations derived from the rights embodied in the securities (dividends, interests), may not expose itself by assuming any payment obligations of settlement members, issuers or any other persons/entities, or engage in any other activities whereby it would assume credit risk.

In case of participant's default to meet his obligations from stock exchange transactions, KDD will immediately employ default procedures in order not to interrupt settlement process. Please see Chapter 7.

1. Under what circumstances and at what point are transfers guaranteed by the SSS?

In case of default (applicable to stock exchange transactions only) KDD enables transfers by employing default procedures. KDD actions are however limited to the assets that constitute Guarantee fund. Assets of the Guarantee fund belong and are provided by KDD members. For further details please see Point F above and Chapter 7.

2. What actions does the guarantee obligate the SSS to take?

Please see Chapter 7 - Default procedures.

3. Please indicate whether the guarantee is a feature of the SSS's rules and procedures or national law or regulations.

Under the provisions of ZTFI, KDD is obliged to establish Guarantee fund and to regulate the detailed guarantee scheme by its Rules and Regulations. More detailed descriptions of guarantee scheme and further default procedures are defined in KDD Rules and Regulations as a part of the membership agreement.

7 DEFAULT PROCEDURES

Events of default are among the most difficult and stressful occurrences that market participants and SSSs may experience. The IOSCO Report underscores the need for transparency in the area of default procedures on the grounds that it will provide more certainty in the operation of critical market mechanism during these stressful events, and thereby reduce the risk that a single default will cause further disruptions.

Because the definition of a default event may differ across system, the IOSCO Report recommends disclosure with regard to the circumstances in which action may be taken, as well as who may take it, and the scope of the actions that may be taken. In some cases, the term "default" may not be used by the SSS in its rules and procedures or in contracts with its participants. In these instances, SSSs should attempt to spell out for their participants both how they would address the insolvency of a participant and any other circumstances in which they would initiate exceptional measures to fulfil settlement or other obligations to their participants.

In this regard, this section attempts to lay out in one place the available resources of the SSS with respect to meeting obligations in the event of a default or other events that would trigger exceptional measures. It is important for participants to understand that these resources are as well as the order in which they will be accessed. The questions also address the possibility that securities or funds transfers will be unwound by the SSS. Because unwinds are a way to reallocate liquidity pressures and credit losses, it is vital that participants understand all the possible circumstances in which an unwind can occur.

DEFAULT PROCEDURES

A. Please discuss the events or circumstances that would constitute default of a participant under the rules and procedures of the SSS or that would lead the SSS to make use of exceptional arrangements or unwind procedures.

According to KDD's Rules and Procedures, a situation in which a member is unable to meet his outstanding obligations towards KDD or other members, would constitute default and KDD would use exceptional settlement arrangements as described below. KDD's default procedures are related to the Stock exchange transactions settlement only.

1.Default of obligation to transfer securities

1.1. Default of obligation to transfer securities of seller's settlement member

Fulfilment of obligation of sellers settlement member is defined as follows:

Seller settlement member shall enter the orders for allocation of sale stock exchange transactions concluded on a respective trading day until the beginning of trading on the trading day following the day of execution of these transactions (T+1) and provide until this time limit the other requirements for execution of these orders. After this time limit and until the settlement day (T+2) until 11 a.m., KDD enters the order for allocation upon application of a seller settlement member. Seller settlement member shall provide the adequate balance of securities on the end seller's account on the settlement day (T+2) until 11 a.m.

Description of a default situation management is to be found below:

If the seller's settlement member on the settlement day until 11 a.m. with respect to a respective sale stock exchange transaction does not provide the requirements for execution of end order for transfer of securities due to settlement of this stock exchange transaction by debiting the end seller's account

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and crediting the end buyer's account, it shall provide on its behalf on the next business day (T+3) until 9 a.m. the advance payment for covering of buy-in costs of securities that were the object of this sale stock exchange transaction by crediting the bank account of the KDD Guarantee fund in the amount that equals the product of:

- the last published uniform price of securities that were the object of this sale stock exchange transaction, increased by 10 percent, and
- the volume of securities that were the object of this sale stock exchange transaction.

KDD may disconnect the seller settlement member from the settlement information system:

1. if it does not provide the requirements for allocation of a sale stock exchange transaction until the beginning of trading on the trading day following the day of conclusion of these transactions, or
2. if it does not ensure the adequate balance of securities on the end seller's account on the settlement day (T+2) until 11.00 a.m.

KDD disconnects the settlement member from the settlement information system on the trading day following the day when the settlement member was in delay with providing the adequate balance of securities on the end seller's account (T+3).

Where a seller settlement member does not timely meet its obligation, KDD acquires a lien (pledge) on all such member's securities recorded in the central registry as guarantee for the repayment of:

1. for a buy-in:
 - the purchase price and other buy-in costs; and
 - the contractual penalty for default,
(in the amount for which it is not possible to repay these claims)
2. for a transaction cancelled by a buyer settlement member:
 - the payment claim; and
 - the contractual penalty
(in the amount for which it is not possible to repay these claims).

KDD may enter and execute the order for entry of lien (pledge) on the settlement day at 11.00 a.m., if the seller settlement member until this time limit does not provide the requirements for execution of end order for transfer of securities due to the settlement of this stock exchange transaction by debiting the end seller's account and crediting the end buyer's account.

KDD begins to execute buy-in on the next trading day after the settlement day (T+3).

KDD shall provide the transfer of securities that are the object of buy-in, by crediting its fiduciary account for buy-in.

KDD shall on the next business day after the day when securities, that were the object of buy-in, were transferred by crediting its fiduciary account for buy-in, enter and execute until 9.00 a.m. the order for transfer of these securities by debiting its fiduciary account for buy-in and crediting the end buyer's account entered in the trading system or in the settlement information system by the buyer settlement member and notify the buyer settlement member thereof.

KDD pays the purchase price for buy-in by debiting the bank account of the Guarantee fund.

In addition it has to be added that if the seller settlement member on the settlement day until 11.00 a.m. does not provide the requirements for execution of the end order for transfer of securities with respect to a particular sale stock exchange transaction due to the settlement of this stock exchange transaction by debiting the end seller's account and crediting the end buyer's account, it shall pay the contractual penalty for delay in the amount of twenty percent of its default obligation, by crediting the KDD's clearing settlement account on the next business day until 9.00 a.m.

The right to a contractual penalty is exercised by KDD in its name and to the credit of the buyer settlement member.

1.2 Default of creditor's obligation of buyer settlement member

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Fulfilment of a creditor's obligation of buyer's settlement member is defined as follows:

Buyer settlement member shall enter the orders for allocation of buy stock exchange transactions, concluded on a respective trading day, until the beginning of trading on the trading day following the day of execution of these transactions and provide until this time limit the requirements for execution of these orders.

After the above mentioned time limit and until the settlement day until 11.00 a.m., KDD enters the order for allocation upon application of a buyer settlement member.

Description of a default situation management is to be found below:

If a buyer settlement member on the settlement day until 11.00 a.m. does not fulfil its creditor's obligation, it may fulfil this obligation after this time limit by issuing to KDD the orders for transfer of securities (that were transferred with the execution of an order by crediting the fiduciary account of KDD for sell-out) by crediting the end buyer's account.

KDD may disconnect the buyer settlement member that does not fulfil the creditor's obligation to provide the requirements for allocation of a buy stock exchange transaction until the time limit, from the settlement information system on T+3.

Where a buyer settlement member does not timely fulfil its obligation, KDD may sell-out securities due under this obligation after transferring them to KDD's fiduciary account for sell-out.

The sell-out shall be performed by KDD in its name, and:

1. the amount of the claim (reduced by the sell-out costs) to the credit of the buyer settlement member;
2. any surplus, above the purchase price credited to other settlement members, is paid as revenue to the guarantee fund.

KDD begins to perform sell-out due to creditor's delay of a buyer settlement member on the next trading day after the settlement day.

KDD shall provide that the purchase price for sell-out is paid by crediting its clearing settlement account after the deduction of sell-out costs.

2. Default of payment obligations

2.1. Default of liquidity reserve payment

Fulfilment of liquidity reserve payment obligation is defined as follows:

Net debtor settlement member shall pay the liquidity reserve if the amount of its net payment obligation exceeds 25 percent of initial principal of the guarantee fund and if the difference between the amount of its net payment obligation and the amount that equals 25 percent of initial principal of the guarantee fund is higher than the amount of paid additional contribution of this settlement member.

Net debtor settlement member shall with respect to stock exchange transactions concluded on a respective trading day, pay the liquidity reserve on the next business day after this trading day until 9.15 a.m.. (T+2).

Description of a default situation management is to be found below:

If the net debtor settlement member until the time limit does not pay the liquidity reserve whose amount exceeds 25 percent of the initial principal of the guarantee fund, the other settlement members shall on the next business day after the day on which the net debtor settlement member should have paid the liquidity reserve, until 9.15 a.m. pay in the guarantee fund the supplementary contributions in the total amount that equals the amount of unpaid liquidity reserve.

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KDD may disconnect the defaulting net debtor settlement member from the settlement information system if the settlement member does not pay the liquidity reserve until the time limit on the trading day when the settlement member was in delay with the payment of liquidity reserve.

Where a net debtor settlement member does not timely settle its obligation to pay liquidity reserve, KDD acquires a lien (pledge) on all securities held by such member and recorded in the central registry as collateral to guarantee the payment of its net payment obligation and default interest.

KDD may enter and execute the order for a lien (pledge) immediately when the net debtor settlement member is in delay with fulfilment of its payment of liquidity reserve

A pledge is executed by the sale executed by KDD in its name and for the benefit of those settlement members for whom KDD credited the settlement account, by ensuring that monetary amount for payment of such sale price is remitted to the credit of the guarantee fund bank account.

2.2. Default of net payment obligation

Fulfilment of net payment obligation is defined as follows:

Net debtor settlement member shall pay its net payment obligation on the settlement day until 11.00 a.m.

Description of a default situation management is to be found below:

If a net debtor settlement member on the settlement day until 11.00 a.m. does not pay the monetary amount in the amount of net payment obligation, KDD until 1.00 p.m. on that day may remit the amount of this net payment obligation by debiting the bank account of the guarantee fund and crediting the clearing settlement account. If there is no covering on the bank account of the guarantee fund for the execution of order for payment, KDD provides the covering on the bank account of the guarantee fund with the exercise of investments of the guarantee fund, if it is possible to exercise them until 1.00 p.m. on the settlement day, or on the basis of liquidity loan with the pledge of assets of the guarantee fund.

If by debiting the guarantee fund, a payment is executed on the basis of liability of other settlement members for fulfilment of obligation of a respective settlement member, and if due to this payment, the basic principal of the guarantee fund is reduced in such a manner that the sum of the basic principal of the guarantee fund and the paid supplementary contributions is less than 75 percent of the initial principal of the guarantee fund, the settlement members, except the settlement member due to fulfilment of whose obligation this payment was executed, shall pay the next business day after receiving the appeal until 9.15 a.m. in the guarantee fund the supplementary contributions in the total amount that equals:

1. the amount of 75 percent of the initial principal of the guarantee fund, reduced for
2. the sum of:
 - the basic principal of the guarantee fund and
 - the amounts of paid supplementary contributions.

The amount of supplementary contribution that shall be paid by a respective settlement member equals the total amount of supplementary contributions multiplied by the share of this settlement member by the liability for fulfilment of obligation of another settlement member.

KDD shall send the appeal for payment of supplementary to settlement members until 2 p.m. on the day on which it performs the payment by debiting the guarantee fund.

KDD may disconnect the net debtor settlement member from the settlement information system if the settlement member does not pay the net payment obligation until the time limit on the next trading day after the day when the settlement member was in delay with the payment of net payment obligation.

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Where a net debtor settlement member does not timely settle its net payment obligation to KDD, KDD may acquire a lien (pledge) on all securities held by such member and recorded in the central registry as collateral to guarantee the payment of its net payment obligation and default interest.

KDD may enter and execute the order for a lien (pledge) immediately when the net debtor settlement member is in delay with fulfilment of its net payment obligation.

A pledge is executed by the sale executed KDD in its name and for the benefit of those settlement members for whom KDD credited the settlement account, by ensuring that monetary amount for payment of such sale price is remitted to the credit of the guarantee fund bank account.

Where a net debtor settlement member does not timely settle its net payment obligation to KDD, KDD acquires the right against this settlement member to execute a sell-out of all securities that were the object of this member's buy stock exchange transactions, whose settlement is performed on the same or latter settlement day, in repayment of the settlement member's net payment obligation.

KDD begins to execute the sell-out of securities due to repayment of net payment obligation of a net debtor settlement member on the next trading day after the day when the net debtor settlement member should have fulfilled the net payment obligation.

KDD shall provide that the purchase price for sell-out would be paid after the account of sell-out costs by crediting the bank account of the guarantee fund.

2.3. Default on contribution to the guarantee fund

Fulfilment of contribution obligation is defined as follows:

Settlement members shall ensure the guarantee fund has sufficient liquid assets to cover their obligations, by paying the required contributions in the guarantee fund.

Each settlement member shall pay to the guarantee fund the basic contribution in the amount determined by the sum of all settlement members' obligations for all their stock exchange transactions executed during a specific period.

Every settlement member shall pay to the guarantee fund such additional contribution in the amount determined by the extent and amount of its own obligations for its own stock exchange transactions executed during a specific period.

Description of a default situation management is to be found below:

KDD may disconnect the settlement member that does not pay the contribution in the guarantee fund at maturity, from the settlement information system.

KDD may disconnect the settlement member from the settlement information system on T+3:

1. if the settlement member did not pay the basic or additional contribution at maturity,
2. if the settlement member did not pay the supplementary contribution at maturity.

If the settlement member does not timely make payment to the guarantee fund, KDD acquires a lien (pledge) on all securities of such settlement member registered in the central registry as collateral for payment of this claim.

KDD may, on its own, enter and execute an order for entry of pledge under upper Paragraph.

KDD executes a pledge in its name and to the credit of the guarantee fund.

1.Failure by participant to meet test of insolvency under the applicable laws of its jurisdiction?

A failure of a participant to meet the criteria of capital adequacy, liquidity or solvency set forth by the ZTFI falls under the Securities Market Agency's (and Bank of Slovenia's, if member is a bank) task of external oversight. The Agency or Bank of Slovenia can initiate proceedings according to the types of violations committed by such participant which result or can result either in temporary or

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permanent withdrawal of its license. KDD is obliged to report to the Agency and Ljubljana Stock Exchange any event of member's default or other significant violation of his obligations.

2. Failure to make payments or deliveries of securities within the time specified?

Please see above.

3. To the extent that the rules and procedures grant discretion in the determination of the use of default or other exceptional procedures, please discuss where the authority to exercise such discretion resides and the circumstances in which this authority would be used.

Under the provisions of ZTFI, KDD is obliged to establish guarantee fund and to regulate the detailed guarantee scheme by its Rules and Regulations in order to effectively manage liquidity and other risks to which other KDD members are exposed in eventual default caused by individual KDD member. KDD Rules and Regulations are very detailed both in the conditions and procedures which are to be followed if such event occurs.

B. What procedures are followed by the SSS once it has determined that a default event has occurred or that exceptional settlement arrangements are to be employed?

Please see above.

1. How and at what point are participants notified that this has occurred?

KDD shall notify of the temporary disconnection of a settlement member from the settlement information system and of the reasons therefore:

- the stock exchange;
- the Securities Market Agency;
- the Bank of Slovenia (if the settlement member is a bank); and
- the other settlement members.

2. Would the SSS be expected to continue to meet all its obligations to participants under these circumstances? (e.g. collateral, participants' fund insurance, loss-sharing arrangements etc.)

Yes, KDD is expected to meet all its obligations towards its members as it has access to sufficient funds and applicable default methods and risk management tools to successfully manage all such events. In addition, as already explained, KDD is prohibited to expose to credit risk. For further details please see the descriptions of applicable default procedures.

3. Please describe and provide a time line indicating the order in which these resources would be used as well as the timing of participant notifications and important deadlines (e.g. when the SSS's obligations to participants would be met, when participants would need to cover their loss-sharing obligations).

If by debiting the guarantee fund, a payment is executed and if due to this payment, the basic principal of the guarantee fund is reduced in such a manner that the sum of the basic principal of the guarantee fund and the paid supplementary contributions is less than 75 percent of the initial principal of the guarantee fund, the settlement members, except the settlement member due to fulfilment of whose obligation this payment was executed, shall pay the next business day after receiving the appeal until 9.15 a.m. in the guarantee fund the supplementary contributions in the

Disclosure framework for securities settlement systems

total amount that equals: the amount of 75 percent of the initial principal of the guarantee fund, reduced for the sum of the basic principal of the guarantee fund and the amounts of paid supplementary contributions.

The amount of supplementary contribution that shall be paid by a respective settlement member equals the total amount of supplementary contributions multiplied by the share of this settlement member by the liability for fulfilment of obligation of another settlement member. KDD shall send the appeal for payment of supplementary contributions to settlement members until 2.00 p.m. on the day on which it performs the payment by debiting the guarantee fund.

For further details on timelines please see explanations of default procedures above.

4. Please describe all conditions under which provisional transfers of securities or funds could be unwound by the SSS.

Not applicable. Transaction unwinding is not possible.

4.1 How and on what authority would a decision to unwind securities or funds transfers be made by the SSS?

Not applicable.

4.2 When and how would participants be notified of a decision to unwind provisional securities or funds transfers

Not applicable.

4.3 How long would participants have to cover any debit positions in their own securities or funds accounts resulting from an unwind?

Not applicable.

4.4 In the event of an unwind, would all transfers be unwound or would only a subset of transfers (e.g. only securities purchases or only those of a subset of participants) be unwound

Not applicable.

4.5 If only a subset of transfers, what procedure would be followed to determine which transfers and in what order?

Not applicable.

5. Can bankruptcy or insolvency be declared retrospectively in the SSS's jurisdiction (e.g. under a »zero – hour« rule), and could this cause provisional securities or funds transfers to be unwound?

There is no any “zero hour rule” or any similar legal provision that could lead to retroactive effects on the settlements of the SSS. The finality of settlement of securities transfers and the payments related to them is legally guaranteed and there is no rule, no law and no practice that would lead to unwinding of the securities or funds transfers after their settlement finality.

6. Please describe any circumstances in which transfers of securities or funds that were defined as final response to question V.E.2 above be unwound?

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Not applicable.

C. Has a participant in the SSS ever been declared in default or become insolvent?

Since June 1996, there have been seventeen cases when participants failed to settle outstanding payment obligations on time.

The activation was due to the members' negligence in presenting their payment orders related to the payment of their additional liquidity reserve amount or their net-to-pay position owed to the KDD. The delay was usually resolved within one to two hours time. Since the delays were unrelated to the members' insolvency, they never resulted in any damages or losses for other members in the securities settlement process.

1. Have loss-sharing procedures been invoked?

Yes, the Guarantee Fund has been activated.

2. Please describe whether any of these defaults or insolvency resulted in losses for the SSS or its participants and how they were absorbed.

These defaults did not result in any losses for KDD or its members. Please see explanation above.

8 SECURITIES OVERDRAFTS, SECURITIES LENDING AND BACK-TO-BACK TRANSACTIONS

In recent years, SSSs have implemented a variety of approaches aimed at satisfying increasing demands for more rapid securities settlements, particularly in the cross-border context. This section focuses on several related issues that can arise in conjunction with these procedures.

The first set of questions in this section relates to the possibility of debit positions in participants' securities accounts as the SSS. Because such positions indicate instances where participants have been allowed to transfer securities that they do not have on deposit at the SSS, they clearly involve substantial risk that the SSS may not be able to obtain the actual securities and complete all necessary settlements. For this reason, it is vital for participants to understand the conditions, if any, under which such debit positions can arise, and what actions the SSS will take to rectify them. The questions also address measures that SSSs can take to reduce or prevent such debit positions.

The existence of securities lending program at the SSS and the conditions under which securities loans are triggered is another important topic covered by the questions in this section. Participants need to understand both when the SSS will arrange for securities to be lent to them and when securities they hold on deposit at the SSS will be made available for lending to others. The existence and terms of securities lending program may also have implications for the SSS's ability to facilitate settlements in a variety of circumstances, particularly for back-to-back transactions.

Back-to-back transactions were a major focus of the Cross Border Report and involve a pair of transactions that require a counterparty to receive and redeliver the same securities on the same day. They have the major advantage of avoiding unnecessary funding costs by the party buying and on selling the securities.

The practice poses no particular risk when the delivery follows an actual final receipt of the securities, as there is then no risk that this receipt would have to be unwound. Especially in the cross-border context, differences in the timing of settlement cycles or of finality have led to the development of practices whereby SSSs in some circumstances allow on-deliveries under back-to-back transactions before the initial securities receipts are final, in effect extending temporary (often intra-day) securities loans. The questions in this section attempt to clarify the circumstances under which this occurs, so those participants can understand the risks entailed by these practices.

SECURITIES OVERDRAFTS, SECURITIES LENDING AND BACK-TO-BACK TRANSACTIONS

A. Is it possible for debit positions (overdrafts) in securities accounts at the SSS to arise?

KDD does not allow having debit positions in securities accounts.

Off-market (OTC-FOP and OTC-DVP) transactions cannot be executed if securities are not available. KDD executes an order or other entry in the central registry if in the account or sub account debited in which the order or another entry is to be executed, there is a quantity of dematerialised securities at least equal to the quantity of dematerialised securities contemplated by such order or other entry. Thus, there is no case in which off-market transactions can result in debit positions in securities accounts.

Stock exchange transactions are settled on T+2 at 1.00 p.m. and required volume of securities should be available till 11 a.m. on T+2 at the latest. Please see Chapter 6 for further details.

1. Under what conditions could such debit positions occur?

Not applicable.

1.1 Do these conditions always result in debit positions in securities accounts rather than failed transactions? If not, please explain the basis for differential treatment by the SSS?

Not applicable.

1.2 Are these situations covered explicitly by the rules and procedures of the SSS?

Not applicable.

2. How long can such debits positions last? How long do they typically last?

Not applicable.

3. How are debit positions in securities accounts prevented, rectified or managed?

They are prevented by risk management procedure as described in detail in Chapter 7.

4. What procedures would be followed by the SSS in case the debit cannot be rectified (e.g. failure by a participant with a debit balance in a securities account or unavailability of securities in the market)?

Procedures described below are applicable to stock exchange transactions only:

Buy-in

Buy-in is the buy of securities executed by KDD to remedy the default on a stock exchange transaction of a settlement member seller to fulfil its obligation to properly and timely ensure the requirements for transfer of securities to the credit of end buyer in accordance with the rules.

The seller settlement member shall, for all its sale stock exchange transactions, on the day and until the hour set forth in the regulations and with respect to all its obligation to transfer securities from such transactions:

1. enter the code of the end seller's account, in the stock exchange trading system or, together with the allocation, in the settlement information system; and
2. ensure the end seller's account is credited with the securities required for this transfer pursuant to such transaction, free from third party rights or legal deeds, except for those that cease upon their transfer to the end buyer's account.

If a seller settlement member does not timely fulfil its obligation, as described above, on maturity of this obligation, KDD may perform a buy-in of these securities.

KDD performs the buy-in:

- in its name;
- to the credit of the end buyer, by the transfer of securities to the credit of its fiduciary account for buy-in, and debiting it for transfer to the credit of the end buyer's account; and
- for other settlement members liable for the fulfilment of such obligations, by paying the purchase price and other costs with respect to buy-in, using the assets of the guarantee fund.

Sell-out

Sell-out is the sale of securities executed by KDD:

- to pay the net payment obligation of a net debtor settlement member; or
- where the buyer settlement member is in creditor's delay to ensure the requirements for transfer of securities to the credit of end buyer in accordance with rules.

Disclosure framework for securities settlement systems

Where a net debtor settlement member does not timely settle its net payment obligation to KDD, KDD acquires the right against this settlement member to execute a sell-out of all securities that were the object of this member's buy stock exchange transactions, whose settlement is performed on the same or latter settlement day, in repayment of the settlement member's net payment obligation.

KDD shall execute a sell-out, in its name and for the account of settlement members to whose debit it covered its settlement account, by ensuring that the purchase price of the sell-out is remitted to the credit of the guarantee fund bank account.

Where a buyer settlement member does not timely fulfil its obligation (i.e. that he shall, for all its buy stock exchange transactions, on settlement day and until the time determined by the regulations, ensure requirements for the settlement of obligations to transfer securities of the seller settlement member are met by entering the code of the end buyer's account in the stock exchange trading system, or, together with the allocation, in the settlement information system), KDD may sell-out securities due under this obligation after transferring them to KDD's fiduciary account for sell-out.

The sell-out shall be performed by KDD in its name, and:

1. the amount of the claim is reduced by the sell-out costs, to the credit of the buyer settlement member;
2. any surplus, above the purchase price credited to other settlement members, is paid as revenue to the guarantee fund.

4.1 Application of loss-sharing provisions allocating the loss to participants?

Coverage of settlement member's liability for other settlement members' obligations

Settlement members are liable for net payment obligation of a net debtor settlement member who does not timely fulfil its obligation. Settlement members are liable for the obligation of a seller settlement member who defaults to ensure transfer of securities on settlement day. Settlement members are not liable for a settlement member's payment of default interest or a contractual penalty, or for an indemnity due on default.

Amount of settlement member's liability for other settlement members obligations

Settlement member is liable to fulfil the obligation of a defaulting settlement member in a share equal to the proportion of such non-defaulting member's share in the guarantee fund and the sum of all shares of all settlement members in the guarantee fund, less the share of the defaulting settlement member. The share of a non-defaulting settlement member in the guarantee fund is equal to the proportion of its basic and additional contributions paid to the guarantee fund and the sum of all paid basic and additional contributions of all settlement members.

Contractual penalty and indemnity for damages on default

Seller settlement member in default of its obligation to ensure securities transfer shall pay KDD a contractual penalty in the amount of twenty percent of such obligation. KDD is entitled to such penalty when the seller settlement member fulfils its obligation after it is due and when KDD executes a buy-in. The right to a contractual penalty is exercised by KDD in its name and to the credit of the buyer settlement member.

Contractual penalty and indemnity for cancellation

If a buyer settlement member exercised its cancellation right, the seller settlement member party to the cancelled transaction shall pay KDD, as a contractual penalty for default on its obligation to ensure securities transfer, an amount equal to fifty percent of the payment for such transaction. The right to this contractual penalty is exercised by KDD in its name and to the credit of the buyer settlement member who exercised the cancellation right.

4.2 Absorption of the loss by the SSS?

No, KDD does not perform services or functions where it would act as a principal.

To avoid any exposure of KDD to credit risk (pursuant to provisions of ZTFI):

- KDD may not act as Central counterparty and
- KDD, in relation to settlement of stock exchange (or any other) transactions with securities, or in relation to payment obligations derived from the rights embodied in the securities (dividends, interests), may not expose itself by assuming any payment obligations of settlement members, issuers or any other persons/entities, or engage in any other activities whereby it would assume credit risk.

4.3 Other? Please specify.

Not applicable.

B. Under what circumstances does the SSS provide for lending of securities to ensure settlement?

At present, the lending service is being performed on a bilateral basis between members only, without any centralized mechanism. Due to the fact that at the end of the trade date (T+0) every KDD member knows what its exact position (resulting from stock exchange trades concluded on T+0) will be in two days when the final settlement occurs, it has sufficient time to promptly borrow the missing securities. In practice the lending occurs employing the OTC-FOP mechanism.

It should be stressed that since 1996, when the KDD started to clear securities market transactions, there was no case of a failed securities settlement; neither did KDD at any time start the buy-in/sell-out procedure (intended to cover the settlement risk). This fact indicates that the settlement risk is well under control in the current infrastructure, thus there seems to be little need present for establishing a centralized securities lending mechanism.

1. Is the process for lending securities automatic? If not, please describe the procedures used by the SSS to determine whether a securities loan will be made.

Not applicable. Please see above.

2. At what point are participants notified that securities are being lent to them?

Not applicable.

3. Which securities on deposit at the SSS are eligible for lending? Do participants have the option to make securities available for lending or is it mandatory?

Not applicable.

4. Are lent securities identified by the SSS with specific participants as lenders or only with common pool of securities available for lending? Does the participant whose securities are lent become a principal to the transaction?

Not applicable.

C. How does the SSS settle back-to-back transactions?

KDD settles back-to-back transactions as any other normal transactions. Back-to-back transactions are regulated under the Ljubljana Stock Exchange Rules. KDD does not engage itself in oversight or conduct of such transactions although it reports them on request.

1. Under what conditions are delivery instructions by participants receiving and redelivering securities on the same day under back-to-back transactions settled for same-day value?

As securities settlement is operated on a trade-for-trade principle, KDD does not regulate back-to-back transactions. It is of no importance to KDD whether a member sells securities before he buys them, as long as both transactions are made on the same trade date. Back-to-back transactions are regulated under the Ljubljana Stock Exchange Rules.

1.1 Only if the participant has securities on deposit with the SSS that have been received pursuant to a final securities transfer?

Not applicable.

1.2 If the participant has securities on deposit with the SSS that have been received pursuant to a provisional securities transfer?

Not applicable.

1.3 Before securities have been received either provisionally or finally, but when a matched receipt instruction exists for the same or greater value? Is such practice limited to markets where matching is binding?

Not applicable.

1.4 Before securities have been received either provisionally or finally, but when a third party has promised to deliver to SSS securities of the same or greater value must the provider of the guarantee have itself received the securities through a final transfer? Please describe how the SSS evaluates such promises, and whether they are addressed by the written rules and procedures of the SSS?

Not applicable.

1.5 Other? Please specify.

Not applicable.

2. Please describe limits or controls in place with respect to any of the above arrangements for the settlement of back-to-back transactions, including limits on amounts involved or related to the liquidity of the underlying securities.

Please see above.

3. Under what conditions are payment instructions by participants in the SSS under back-to-back transactions settled for same-day value? Can participants use the proceeds of an on-delivery of securities without the need for an extension of credit?

Disclosure framework for securities settlement systems

KDD operates a so called rolling settlement T+2 system - a system where securities transactions are being settled against payment. Funds and securities are available after the batch is run and KDD does not offer any credit facilities to its members. Therefore no expected payment or on-delivery can be used to settle the initial buy transaction.

9 RISK CONTROL MEASURES

This section of the disclosure framework is intended to provide a description of the risk management systems employed by the SSS. Sound risk management encompasses a number of aspects, including assessment of risks and senior management and Board of Directors input into the risk management process, particularly with respect to the review of new products and services by the SSS. Internal and external audits as well as supervisory oversight can also play a vital role in ensuring that the risk management approach is sound and implemented with integrity.

A range of different risks can arise in conjunction with the different services that SSSs may provide. For example, in the course of providing settlement services, the SSS may become exposed to credit, custody or liquidity risks if it either explicitly or implicitly extends funds credit or lends securities to participants. In the provision of custody services, the SSS may take on credit risk if it extends funds to or on behalf of third parties. A variety of risk management approaches to these risks are possible, including in particular the use of collateral or limits on risk exposures. The questions also addresses several other provisions or tools that may be helpful to SSSs in managing or containing the different risks that they face, but are not meant to exhaust all the possible approaches that SSSs may employ.

RISK CONTROL MEASURES

A. **Please describe the role and responsibilities of those areas of the SSS responsible for risk management and control.**

In the process of clearing and settlement of the stock-exchange transactions, the risk related to the securities leg settlement is principally the risk of non or delayed delivery, since the KDD intervenes with activating the Guarantee fund and the buy-in/sell-out procedures in the case of a member's default.

In order to cope with the effects of the default of a member, KDD has detailed procedures and a robust risk management infrastructure in place, thus the probability of a non or delayed delivery is of very little concern.

In this context it should be stressed that since 1996, when the KDD started operating, no case of failed securities settlement due to non or delayed delivery has ever occurred.

Most of the risks associated to the clearing process are concentrated in the area of facilitating timely settlement of payment obligations. For this reason, two main types of risk management tools have been established in order to ensure the timely cash settlement: the Liquidity Reserve Fund and the Guarantee Fund.

The aim of the **Liquidity Reserve Fund**, which shall be paid on the next business day after trading day (T+1) until 9.15 a.m. and is a sort of prepayment of member's net payment obligation in the case his net obligation exceeds certain amount as described below, is to facilitate that the cash transactions will take place when due, since in a way it 'signals' the member's financial capability to cover its obligations when due.

The KDD calculates the Liquidity Reserve requirements for each individual member on a daily basis. It is based on the member's daily operations. More precisely, if the member's daily net obligation exceeds the amount that equals 25 percent of initial principal of the guarantee fund and the amount of paid additional contribution of this settlement member, the member must pay the difference into the Liquidity Reserve Fund. For a trade matched within the operating hours of the Ljubljana Stock Exchange on day T+0, the calculation of the liquidity reserve requirement becomes final and irrevocable by 2.45 p.m. on T+0 and is due by 9:15 a.m. on T+1.

The **Guarantee fund** is constituted of those assets maintained by KDD in its own name and at its disposal for the account of settlement members, and particularly:

Disclosure framework for securities settlement systems

- for the benefit of settlement members, when KDD exercises its rights over these assets or rights in relation to a specific settlement member in default of its obligation from a stock exchange transaction; and
- on behalf of settlement members, to meet their obligations for a liability to fulfil other settlement members' obligations from stock exchange transactions.

A **guarantee fund bank account** is a bank account of KDD maintained at the Bank of Slovenia, to the credit and debit of which payments to and from the guarantee fund are made.

In relation to KDD's creditors, the holdings in the guarantee fund bank account and other assets of the guarantee fund are considered assets of settlement members.

A settlement member is liable to fulfil the obligation of a defaulting settlement member in a share equal to the proportion of:

- such non-defaulting member's share in the guarantee fund; and
- the sum of all shares of all settlement members in the guarantee fund, less the share of the defaulting settlement member.

The share of a non-defaulting settlement member in the guarantee fund is equal to the proportion of:

- its basic and additional contributions paid to the guarantee fund; and
- the sum of all paid basic and additional contributions of all settlement members.

Each settlement member shall pay in the guarantee fund the basic contribution whose amount is determined according to the extent and amount of obligations that were established on the basis of all stock exchange transactions of all settlement members, concluded in a particular period and also the additional contribution whose amount is determined according to the extent and amount of its own obligations that were established on the basis of its own stock exchange transactions, concluded in a particular period.

As the guarantee fund is now deposited at the Bank of Slovenia, the elimination of both the risk of failure of the commercial bank (where it was previously deposited), and the risk of delayed mobilization of funds in case of a stress situation, is achieved.

1. Please describe the process for internal review of risk management policies and procedures.

Internal Audit Department of KDD is directly responsible to the Management Board. It performs continuous internal control of all business practices, management practices, and technical arrangements as well as the appropriateness of an ongoing identification, monitoring and management of risks. All internal risk management issues and policies are subject to KDD's Board of Directors approval.

2. Is there a risk management policy that addresses the review and approval of the new products and services offered by the SSS? At what level of the organization is risk management approval given for a new product or services?

Please see above.

3. Does the SSS have a risk management function with clear independence from authority over operational or marketing function?

Yes.

4. Does Board of Directors review risk management or audit committee?

Please see below.

B. Please describe any internal or external auditor supervisory / regulatory examinations that are performed with respect to the SSS. For each such audit or examination, please address the following questions.

KDD is subject to the following types of controls:

- prudential supervision by the Securities market agency in the capacity of competent authority for supervision of organized securities markets and investment services,
- supervision by the Bank of Slovenia in respect of systemic risk of settlement system and in the capacity of operator/manager of national component of RTGS TARGET2 payment system,
- audit of tax statements by the Tax Administration Office,
- external (statutory) audit of accounting statements by independent auditing company,
- internal audit by Internal audit department.

Prudential supervision by the Securities market agency

Objective of prudent supervision by the Securities market agency is to protect integrity of organized securities market and interests of investors in securities.

Pursuant to ZTFI, Securities market agency is empowered and responsible for supervision of all services provided by KDD.

Pursuant to ZTFI, CSD has to obtain a license for performing CSD services from Securities market agency. KDD has acquired such a license.

Pursuant to ZTFI, Securities market agency performs supervision of KDD with regard to compliance with provisions set forth in ZTFI (and other Acts and Regulations issued on the basis of ZTFI), ZNVP and other Acts and Regulations, that regulate operations with financial instruments. In addition, pursuant to ZTFI, Securities market agency should consider provisions of certain Articles of Chapters 7.3, 7.4 and 7.6 of ZBan-1 (Banking Act), which apply mutatis mutandis also to Securities market agency's supervision of KDD.

Pursuant to ZTFI, Securities market agency performs supervision of KDD with:

- Collecting and examining reports, announcements and other information issued by KDD and other entities, that are obliged to report pursuant to ZTFI or other relevant Act;
- Revisions of KDD's operations, pursuant to ZTFI;
- Taking measures in case of violations of provisions set forth in ZTFI or other relevant Act.

Pursuant to ZTFI, Securities market agency can impose the following measures against KDD:

- warning;
- order to remedy a violation of provisions of ZTFI or other relevant Act;
- withdraw license for CSD operations.

The supervision is performed on an ongoing basis by monitoring and assessing the compliance of clearing and settlement services and maintenance of central registry provided by KDD with the provisions of ZTFI, ZNVP and other relevant Acts and Regulations.

Supervision by the Bank of Slovenia

Disclosure framework for securities settlement systems

Pursuant to ZTFI, Bank of Slovenia performs supervision of KDD in respect of systemic risk of settlement system. To handle systemic risk of settlement system properly, supervision of the Bank of Slovenia should be (if needed) done in close cooperation with Securities market agency.

Pursuant to ZTFI, the provisions of Chapter 7 of ZBan-1 (Banking supervision) apply mutatis mutandis to supervision of KDD and determine exact scope of Bank of Slovenia's examination duties.

The Bank of Slovenia, in its role of operator/manager of national component of RTGS TARGET2 payment system (i.e. TARGET2-Slovenija), is responsible for supervision of all TARGET2-Slovenija system participants (including KDD) in case of their malfunctioning. With the intention of ensuring smooth functioning of the payment system, the Bank of Slovenia is concerned primarily with two factors: sufficient liquidity of all TARGET2-Slovenija system participants as well as their operational soundness.

Audit of tax statements by the Tax Administration Office

The only objective of tax audit is assessment of compliance with tax obligations (duties).

External (statutory) audit of accounting (financial) statements

The objective of external (statutory) audit is the assessment of whether KDD's financial statements comprised in the annual report are true and fair. Audit is performed annually by external independent auditors.

Pursuant to ZTFI, annual report of KDD is subject to obligatory (external) auditor's review. Pursuant ZTFI, the provisions of ZBan-1 regarding the auditor's review for bank's annual report (certain Articles of Chapter 5 of ZBan-1) apply mutatis mutandis also to the audit of KDD's annual report.

Pursuant to ZBan-1 which further defines the scope of external audit of annual report and is also mutatis mutandis applicable to KDD, the auditor also has to report to Securities market agency any circumstances that would constitute an important violation of Rules and Regulations defining the activities of KDD or could influence the continuous operation of KDD or could result in the qualified or adverse auditor's opinion or in the rejection of the such opinion. The annual report and the auditor's report have to be published on KDD's web page.

Internal audit by Internal audit department

Pursuant to ZTFI, KDD is obliged to establish and to execute firm, reliable and efficient management system, including inter alia appropriate internal audit system, comprising of proper administrative and accounting procedures. ZTFI further defines auditing of CSD and imposes the obligation to KDD to organize internal audit department.

According to certain provisions of ZBan-1, which with respect to internal audit applies mutatis mutandis also to KDD, the latter shall organize its internal audit as an independent department which is directly subordinated to the KDD's management board and is separated from other organizational units. The purpose, importance and tasks of the internal audit department shall be defined by a written document approved by the KDD's management board in agreement with the supervisory board. Internal audit includes inter-alia review, assessment and testing of efficiency of internal control systems as well as the assessment of reliability of the information system, including the electronic information system and electronic services.

Disclosure framework for securities settlement systems

The internal audit unit shall audit KDD's operations in accordance with standards of professional conduct for internal auditing, code of principles of internal audit and code of ethics of internal auditors. The annual plan of activities of the internal audit unit shall be based on the assessment of risks made at least once a year.

Detailed scope of Internal auditing duties is defined in ZBan-1, which apply mutatis mutandis also to the KDD's Internal auditing department (pursuant to ZTFI). KDD internal audit functions are defined as follows:

- Monitoring and evaluating the efficiency of risk management systems and providing assistance in risk management,
- Review, assessment and testing of efficiency of internal control systems,
- Assessment of reliability of the information system, including the electronic information system,
- Assessment of accuracy and reliability of accounting records and financial reports,
- Verification of completeness, reliability and timeliness of reporting in compliance with regulations,
- Verification of compliance of the operations with regulations, internal rules and measures adopted on their basis,
- Conduct of special investigations.

1. Who performs the examination?

Please see above.

2. What is the scope of audit and examination? Please indicate whether and how it addresses the sufficiency of and compliance with internal controls. Please indicate whether and how it addresses the SSS's compliance with its own rules and procedures.

The internal audit department prepares strategic, operational and annual plans. The strategic plan follows the long-term audit objectives in finance, operational procedures, technical and employment fields, and it's usually prepared for a five year term. The operational plan is based on the annual plan and is composed of detailed audit plans. The annual plan defines fields which will be subject to audit reviews and foresees the required resources for successful execution of planned reviews. All plans are subject to CEO's approval. Based on the approved plans the internal audit department performs its regular reviews. Exceptional reviews are performed by the same department on CEO's request. The internal auditor assesses operational risks and internal control risks (e.g. if the control system and control procedures are adequate with regard to the management policies, procedures legal standards,...). The results of both audit reviews are featured in the audit reports. For details on scope of audit and examination of other authorities please see above.

3. What is the frequency of the audit or examination?

Periodicity of controls is subject to arbitrary decision of the respective authority, except for the external financial (accounting) audit that is performed annually by independent accountants. Internal auditing is conducted on a continuous basis. Moreover, the internal audit department policy is related to long and short range planning as described above (strategic, operational and annual plans).

4. Are audit or examination reports available for review by participants?

Audit reports are usually not available for KDD's members review, but can be made available on appropriate authority's decision (e.g. Securities Market Agency, KDD's Board of Directors for financial audit reports, Bank of Slovenia,..).

The annual report and the auditor's report have to be published on KDD's web page.

C. Please discuss whether the SSS has the capacity to value (i.e. marked to market) the securities that it holds.

KDD can evaluate all securities listed on the Ljubljana Stock Exchange, using market prices of such securities. The market value of all other securities which are not listed on the organized market is not known to KDD.

1. Please describe how these valuations are used by risk control systems at the SSS.

The valuations (securities prices) are indirectly used in Guarantee fund calculations.

Description of the composition (contributions) of the Guarantee Fund:

The Guarantee fund consists of:

- annual basic contributions (the same amount is applied to each member), which are determined by the sum of all settlement members' obligations for all their stock exchange transactions executed during a specific period,
- monthly additional contributions (determined individually for each member) in the amount determined by the extent and amount of the member's own obligations from stock exchange transactions executed during a specific period and
- supplementary contributions, actually representing replenishment of the Guarantee Fund (determined individually for each member in relation to its share under the liability for fulfilment of obligation of another settlement member), which are required when a payment is performed on behalf of the Guarantee Fund for a liability in case of delivery or payment failure. Supplementary contributions are required every time the sum of the basic principal of the Guarantee Fund and the paid supplementary contributions is less than 75 percent of the initial principal of the Guarantee Fund. In this regard, the non-defaulting members therefore guarantee the settlement with their whole liquidity. Supplementary contributions are refunded after the payment claim against the defaulting settlement member, whose obligation was fulfilled using assets of the Guarantee Fund, is exercised.

A detailed description of calculating basic, additional and supplementary contributions, the periods of their calculation, the settlement of their payment, and the time periods for payments of contributions are further prescribed by *Regulations of KDD on Settlement of Stock Exchange Transactions*.

2. How frequently are securities revalued?

Securities, listed on the Ljubljana Stock Exchange can be valued daily, or even more frequently since the price of a given security is available on a real time basis.

3. What are the sources of securities valuation?

The source of the securities valuation is the official Ljubljana Stock Exchange price list. Real time securities market prices are also available in the Ljubljana Stock Exchange trading system.

D. Please discuss whether the SSS has a lien on the securities held in or transferred through it.

Disclosure framework for securities settlement systems

In principle KDD has no lien (pledge) on any securities held or transferred through KDD's system of dematerialised securities accounts maintenance. The only exception is the right to pledge securities in case of a member's default.

1. Does the lien apply only to the securities owned by the participants themselves or does it extend to the securities beneficially owned by customers or participants?

The pledge in case of a member's default extends on all securities entered on his house account in the central registry.

2. Under what circumstances and in what manner would such a lien allow the SSS to use the securities?

Where a seller settlement member does not timely meet its obligation pursuant to KDD Rules and Regulations, KDD acquires a lien (pledge) on all such member's securities recorded in the central registry as guarantee for the repayment of:

1. for a buy-in:

- the purchase price and other buy-in costs; and
- the contractual penalty for default,

(in the amount for which it is not possible to repay these claims);

2. for a transaction cancelled by a buyer settlement member:

- the payment claim; and
- the contractual penalty,

(in the amount for which it is not possible to repay these claims).

KDD may enter and execute a pledge.

KDD exercises the pledge on those securities according to the out-of-court sale rules of a pledged asset and in the manner set forth in the Rules and Regulations.

E. Please discuss the circumstances in which the SSS requires collateral to limit or mitigate risk.

KDD does not run a collateral system.

The only case in which collateral is required by KDD is the case of takeover proceedings. The bidder must make a public offer to all shareholders of the target firm. At the same time he must deposit cash or provide collateral for all net to pay obligations that may arise from acceptances of its public offer.

1. Does the SSS manage its own collateral system?

Not applicable. Please see above.

1.1 Does the SSS share a collateral system with another SSS or payment system?

Not applicable.

1.2 Can collateral at the SSS be posted and returned on the same day?

Not applicable.

Disclosure framework for securities settlement systems

1.3 What types of transaction at the SSS involve the use of collateral?

The use of collateral is triggered only in case of a bidder's non performance under its net to pay obligations in case of takeover.

1.4 What are the policies with regard to the type of collateral used or haircuts required?

Not applicable.

1.5 How are collateral valuations methodologies developed and reviewed?

Not applicable.

1.6 To what extent are collateral policies described in the written rules and procedures of the SSS?

The above mentioned collateral procedures are to be found in the *Regulations of KDD on ZPre-1 take-over bid procedures*.

F. Please describe the SSS's use of limits on exposures to monitor or control risk.

1. Please explain the types of limit used and the exposures to which they apply

As already explained, the securities accounts may not be overdrawn.

1.1 Do the limits apply to all participants and/or other SSSs with which the SSS is linked?

Not applicable.

1.2 Do limits apply to participants individually or in the aggregate or both?

Not applicable.

1.3 Do limits apply to implicit as well as explicit extensions of credit or securities (e.g. when on-delivers of securities are permitted pursuant to provisional but not final delivery of securities)?

Not applicable.

1.4 Does the SSS automatically reject transactions that exceed limits or in compliance determined ex post?

KDD does not reject such (stock exchange) transactions. Outstanding obligations (in case of default) will be met by activation of default procedures described in Chapter 7- Default procedures.

1.5 How are limit policies developed and reviewed?

They are developed by the KDD's relevant departments and presented for adoption to the Board of Directors.

1.6 To what extent are limit policies described in the written rules and procedures of the SSS? Where does additional authority to set or amend limit policies reside?

Disclosure framework for securities settlement systems

As already explained, ZTFI regulates explicit prohibition of KDD from exposing to credit risk.

G. Please describe other controls to mitigate or reduce risk at the SSS.

1. Does the SSS or its participants have the capacity to monitor participants' accounts continuously during processing?

KDD can monitor members' securities accounts continuously, but that does not apply to their cash accounts. The monitoring applies to all participants' securities accounts including those of their clients.

2. Is there a special risk control regime that the SSS would apply to a participant known to be experiencing financial difficulties?

If a member is experiencing financial difficulties special procedures are put in place as described in detail in Chapters 7 and 8. The outcome of such procedures does depend on the extent of financial difficulties.

At the same time, there are also procedures that are to be followed by the Securities Market Agency, Ljubljana Stock Exchange and the Bank of Slovenia.

3. Does the SSS maintain or administer loss-sharing arrangements other than those applicable to events of default and addressed in section VI. above? Are these loss-sharing pools pre-funded by participants?

At the moment there are no loss-sharing arrangements other than those described above.

10 OPERATIONAL RISKS

Operational failures at the SSS could limit participants' ability to access their assets held at the SSS and prevent them from honoring their commitments to others, with potential spillover effects on other payments, clearance, and settlement systems. Furthermore, prolonged problems could reduce or eliminate trading activity with respect to the affected securities, with substantial consequences for market participants.

It is good practice to mitigate operational risks through redundancy and the maintenance of strong internal controls over the operations of the SSS. In the event of an unavoidable problem or natural disaster, the SSS should also have in place a well-rehearsed plan for business continuity that addresses all the business functions and resources that the SSS would need to renew operations.

OPERATIONAL RISKS

A. Please provide assessment of the operational reliability of the computer and other systems used by the SSS, including any criteria that the SSS uses internally for this purpose.

1. What is the percentage uptime of the system used by the SSS?

1.1 Whole system overall?

The percentage uptime of the KDD's information system was as follows:

1995: 96,5%

1996-2010: 100%

1.2 Broken down by major components?

Please see 1.1 above.

1.3 During critical processing periods?

Please see 1.1 above.

2. Has the SSS experienced major operational problems during the past two years?

No, KDD has never experienced any major operational problem since its founding in January 1995. There was, however, a minor problem in 1995 when old information system only started operating. The problem was due to operating system disk management failure.

Another minor problem occurred in June of 2005 when the communication server experienced some problems. The system was fully accessible to the members in about 3 hours from the beginning of the problem. In the meantime alternative methods of operations in accordance to the Business Continuity Plan were activated and SSS members conducted their operations normally.

2.1 Have settlements been delayed, been disrupted or otherwise failed because of operational problems during this period?

Settlements have never been delayed, disrupted nor have they otherwise failed.

2.2 Please describe nature of any such problems.

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The operating system disk management failure (mentioned above) arose from an IBM's operational system bug, namely, during processing the journal generation filled up the whole disk capacity. The problem was solved by inserting additional memory (disk) so that the processing could continue.

B. Please describe contingency or disaster recovery planning at the SSS.

Pursuant to ZTFI, KDD has to prepare Emergency Plan and Business Continuity Plan.

Emergency plan is available in the event of malfunction or breakdowns. In order to cope with emergency situations KDD developed a Business Continuity Plan, which is currently being even renewed following the BS 25999 standard. The Plan is based on a risk management approach. The general aspects covered in the plan are the network recovery, the system recovery, and the user recovery. For these purposes, emergency planning is concerned with the backup of all computer files, the off-site data storage, the safekeeping of backup files, as well as maintaining the off-site disaster recovery facility with real time data replication.

As regards the level of detail in the plan, the Business Continuity Plan includes the procedures in place regarding all the critical business processes, as well as the list of responsible emergency teams for activating the disaster recovery location.

The plan foresees the restoration of the KDD's main services within the time span of maximum 4 hours, by either reactivating the main system or switching to the disaster recovery location. However, KDD would publicly announce any system interruptions. It would notify KDD members, Ljubljana Stock Exchange, Securities market agency and Central Bank.

KDD has a disaster recovery (i.e. mirror) facility in Koper (about 100 km from the main operation site in Ljubljana). This secondary location started operating in July 1999. At that time it was equipped with all the necessary hardware, software, and communications equipment for 20-25 people. Facility was enlarged and modernised in 2009 to accommodate 35 people. All daily-received and daily-sent data replicates online to the mirror location's server which enables the mirror location to take-over all main business operations within the time span of 4 hours since the start of a potential disaster.

Parts of the Business Continuity Plan are available for review by members, but not to the public. For instance, in the event of malfunctioning of the electronic communication link between the KDD system and its members, the LJSE, or the Bank of Slovenia, it is also possible to use the magnetic media, fax or stand-by communication links between the institutions. In addition, several workstations are available in KDD's premises in case of emergency for KDD members.

1. Does the SSS have a formal plan for business continuity in place?

Please see above.

2. Is this plan available for review by participants?

Parts of the Business Continuity Plan are available for review by KDD participants, but not to the general public.

3. How often is the plan tested? Does this involve participants in the SSS?

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The Business Continuity Plan and/or its integral parts are subject to regular periodic testing and in some areas this procedure involves also participant members (data control lists), the stock exchange (data control lists), the Central Bank (functioning of the payment system).

Testing of BCP procedures by KDD only is performed on quarterly basis. Testing with our members (Bank of Slovenia being a KDD member) and Ljubljana Stock Exchange is performed annually.

4. What are the major elements of the business continuity plan?

Please see above.

5. How long would it take the SSS to resume operations if primary system becomes unstable?

The plan foresees the restoration of the KDD's main services within the time span of maximum 4 hours, by either reactivating the main system or switching to the disaster recovery location. However, KDD would publicly announce any system interruptions. It would notify KDD members, Ljubljana Stock Exchange, Securities Market Agency and the Bank of Slovenia.

C. What are the key features of the internal controls covering operations and security at the SSS (e.g. change controls or those covering remote access)?

1. Please describe controls or security procedures in place to ensure that the SSS acts only on authentic settlement instructions by valid participants.

Yes, there are measures in place to prevent unauthorized access to the system, as well as unauthorized use of participants' securities. KDD developed information security management system based on ISO 27001 which comprises organizational (i.e. policies), technical and application controls. The authenticity of participants and their instructions are primarily ensured by two level access controls for each application. Authorization procedures are constituted mainly by personal digital certificates issued by trusted certificate authorities. KDD demands an exact list of user privileges granted to members' employees, which are in turn provided with user IDs directly related to the personal digital certificates. In that way every order sent into the information system is digitally signed in order to guarantee total integrity and non-repudiation of sent data which are contained in the particular order (i.e. instruction). In that way maximum data accuracy and security is achieved.

There are also different levels of access to facilities, applications and data-bases applied according to one's privileges. Furthermore, all communications are SSL 128 bits encrypted. All of that ensures that each action taken in the system can be traced to its origin – workstation, time of entry and user's ID.

Pursuant to ZTFI, KDD has to treat as confidential all information about issuers, holders, members and other persons/entities. KDD's employees, shareholders and other persons, who dispose with confidential information, are prohibited from disclosing confidential information to third persons.

2. Are internal operational and security controls included in the internal and/or external audits of the SSS?

Yes, all of internal operational and security controls are audited internally.

In addition, external auditor (the same as for financial statements) performed the external auditing of KDD's information system. The auditing included also internal operational and security controls.

3. Are internal operational and security controls covered by regulatory requirements applicable to the SSS?

Yes, provisions of ZTFI address those requirements. In addition, they are in detail regulated by the KDD Rules and Regulations.

D. Does the SSS impose minimum operational or performance standards on third parties (e.g. communication providers)?

Yes, third parties are contractually liable for minimum technical, operational and performance standards. Other than that, third parties are liable to KDD under general obligations rules.

1. How does the SSS ensure that such standards are met on a continuing basis and what sanctions are available to the SSS if they are not?

Please see above.

2. How would the SSS allocate losses incurred due to operational problems caused by third parties?

KDD is generally liable to its participants as described in Chapter 3 and 4 as is the party who originated the loss caused to KDD. The third party is moreover liable for all breaches of agreement with KDD. Therefore KDD would assert its damage payment claim through normal legal proceedings (e.g. through courts).

11 GLOSSARY

The following glossary of terms is not intended to provide legally precise definitions for all relevant jurisdictions. Rather, by clarifying the usual meaning of various terms, it is intended as a tool to help in answering the questions in the disclosure framework and in understanding the responses to those questions.

Back-to-back trades: a pair of transactions that requires a counterparty to receive and redeliver the same securities on the same day. The transactions involved may be outright purchases and sales or collateral transactions (repurchase agreements or securities loans). For example, a securities dealer might buy and sell the same securities for the same settlement date in the course of making markets for customers or it might buy securities for inventory and finance the position through a repurchase agreement.

Beneficial ownership/interest: entitlement to receive some or all of the benefits of ownership of a security or a financial instrument (e.g. income, voting rights, power to transfer). Beneficial ownership is usually distinguished from "legal ownership" of a security or a financial instrument.

Bilateral netting: netting between two parties.

Book-entry system: an accounting system that permits the electronic transfer of securities without the movement of certificates.

Bridge: the "bridge" is the name commonly used for the link between Euroclear and Cedel that permits cross-system settlement of a trade between a participant in one ICSD and a participant in the other ICSD.

Cash correspondents: banks (or similar institutions) used by the SSS to make or receive payments.

Cash deposit risk: the credit risk associated with the holding of funds with an intermediary for the purpose of settling securities transactions.

Cash memorandum accounts: records kept by the SSS of the funds due to be paid to or received by participants in conjunction with their securities settlements; the records are for information purposes only and do not represent legal claims or liabilities between the SSS and its participants.

Central securities depository (CSD): an institution for holding securities, which enables securities transactions to be processed by means of book entries. Physical securities may be immobilized by the depository or securities may be dematerialised (so that they exist only as electronic records).

Certificate: the document, which evidences the undertakings of an issuer of a security or financial instrument.

Chaining: a method used in certain settlement systems for processing transfers. It involves the manipulation of the order in which transfers are processed to increase the number or value of transfers that may be settled with available securities and funds balances (or available credit lines)

Clearance: the term "clearance" has two meanings in the securities markets. It may mean the process of calculating the mutual obligations of market participants, usually on a net basis, for the exchange of securities and money. It may also signify the process of transferring securities on the settlement date, and in this sense the term "clearing system" is sometimes used to refer to securities settlement systems. In this disclosure framework, the term is used only in the first sense.

Collateral: an asset or third party commitment that is accepted by the collateral taker to secure an obligation of the collateral provider vis-à-vis the collateral taker.

Confirmation: the process by which a market participant notifies its customers of the details of a trade and allows the customer to positively affirm or question the trade.

Counterparty: one party to a trade.

Credit risk: the risk that a counterparty will not settle an obligation for full value, either when due or at any time thereafter. Credit risk includes replacement cost risk, principal risk and cash deposit risk.

Cross-border settlement: a settlement that takes place in a country other than a country in which one trade counterparty or both are located.

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Custodian: an entity, often bank, that safekeeps and administers securities for its customers and that may provide various other services, including clearance and settlement, cash management, foreign exchange and securities lending.

Custody-only links: a link between two SSSs which enables transactions in securities held in SSS1 to be settled using SSS2 (rather than SSS1) when the buyer and seller are both participants in SSS2. Custody-only links do not provide for the transfer of funds between SSS1 and SSS2 and cannot be used to settle transactions between a participant in SSS1 and a participant in SSS2.

Custody risk: the risk of loss of securities held in custody occasioned by the insolvency, negligence or fraudulent action of the custodian or of a sub-custodian.

Customer: a buyer, seller or holder of securities and financial instrument that does not participate directly in a system. A participant's holdings in a system often include securities and financial instruments of which the participant's customers are the beneficial owners.

Daylight credit (or daylight overdraft, daylight exposure, intraday credit): credit extended for a period of less than one business day; in a credit transfer system with end-of final settlement, daylight credit is tacitly extended by a receiving participant which accepts and acts on a payment order, even though it will not receive final funds until the end of the business day.

Debit balance: see net debit position.

Default: failure to complete a funds or securities transfer according to its terms for reasons that are not technical or temporary, usually as a result of bankruptcy. Default is usually distinguished from a "failed transaction".

Delivery: final transfer a security or financial instrument.

Delivery versus payment: a link between a securities transfer system and a funds transfer system that ensures that delivery occurs if, and only if, payment occurs.

Dematerialization: the elimination of physical certificates or documents of title which represent ownership of securities so that securities exist only as accounting records.

Depository receipt: an instrument issued in one country that establishes an entitlement to a security held in custody in another country.

Domestic settlement: a settlement that takes place in the country in which both counterparties to the trade are located.

Domestic trade: a trade between counterparties located in the same country.

Failed transaction: a securities transaction that does not settle on the contractual settlement date, usually because of technical or temporary difficulties.

Finality risk: the risk that a provisional transfer of funds or securities will be rescinded.

Final transfer: an irrevocable and unconditional transfer, which effects a discharge of the obligation to make the transfer. The term's "delivery" and "payment" are each defined as a final transfer. See provisional transfer.

Forced settlement: securities or funds settlement that is either mandated or enforced by the actions of a third party.

Global custodian: a custodian that provides its customers with custody services in respect of securities traded and settled not only in the country in which the custodian is located but also in numerous other countries throughout the world.

Gridlock: a situation that can arise in a funds or securities transfer system in which the failure of some transfer instructions to be executed (because the necessary funds or securities balances are unavailable) prevents other instructions from being executed on the scheduled date.

Gross settlement system: a transfer system in which the settlement of funds or securities transfers instructions occurs individually (on an instruction-by-instruction basis).

Haircut: the difference between the market value of a security and its collateral value. The haircut is intended to protect a lender of funds or securities from losses owing to declines in collateral values.

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Immobilization: placement of certificated securities and financial instruments in a central securities depository to facilitate book-entry transfers.

Internal settlement: a settlement that is effected through transfers of securities and funds on the books of a single intermediary. An internal settlement requires both counterparties to maintain their securities and funds accounts with the same intermediary.

International central securities depository (ICSD): a central securities depository that settles trades in international securities and in various domestic securities, usually through direct or indirect (through local agents) links to local CSDs.

Irrevocable transfer: a transfer, which cannot be revoked by the transferor.

Issuer: the entity that is obligated on a security or financial instrument.

Issuing agent: an institution that acts on behalf of the issuer of securities in distributing the securities and in realizing the proceeds thereof for the benefit of the issuer.

Legal Ownership: recognition in law as the owner of a security or financial instrument.

Legal risk: the risk of loss because of the unexpected application of a law or regulation or because a contract or other right cannot be enforced.

Liquidity risk: the risk that a counterparty will not settle an obligation for full value when due, but on some unspecified date thereafter.

Local agent: a custodian that provides custody services for securities traded and settled in the country in which it is located to trade counterparties and settlement intermediaries located in other countries (non-residents).

Local custodian: a custodian that provides custody services for securities traded and settled in the country in which the custodian is located. See global custodian.

Loss-sharing agreement: an agreement among participants in a clearing or settlement system regarding the allocation of any losses arising from the default of a participant in the system or of the system itself.

Loss-sharing pools: cash, securities or possibly other assets that are provided by the participants in advance and are held by the system to ensure that commitments arising from loss-sharing agreements can be met.

Marking to market: the practice of revaluing securities and financial instruments using current market prices. In some cases unsettled contracts to purchase and sell securities are marked to market and the counterparty with an as yet unrealized loss on the contract is required to transfer funds or securities equal to the value of the loss to the other counterparty. See variation margin.

Matching (or comparison, checking): the process for comparing the trade or settlement details provided by counterparties to ensure that they agree with respect to the terms of the transaction. Settlement instructions that have been successfully matched between counterparties are referred to as matched settlement instructions. In some securities settlements systems, penalties may apply to participants that unilaterally revoke matched settlement instructions. In other systems, unilateral revocation of matched settlement instructions may not be possible.

Member: in this disclosure framework, the term is used synonymously with participant. See participant.

Multilateral netting: netting among more than two parties.

Net credit or net debit position: a participant's net credit or net debit position in funds or in a particular security is the sum of all the transfers it has received up to a particular time less the transfers it has sent; if this sum is positive, the participant is in a net credit position, if the sum is negative, it is a net debit position. The net credit or net debit position at settlement time is called the net settlement position. These positions may be calculated on a bilateral or multilateral basis.

Net settlement: a settlement in which a number of transactions between or among counterparties are settled on a net basis.

Netting: an agreed offsetting of mutual positions or obligations by trading partners or participants in a system. The netting reduces a large number of individual positions or obligations to a smaller number of positions. Netting may take several forms, which have varying degrees of legal enforceability in the event of default of one of the parties.

Nominee: a person or entity named by another to act on his behalf. A nominee is commonly used in a securities transaction to obtain registration and legal ownership of a security.

Obligation: a duty imposed by contract or law. It is also used to describe a security of financial instrument, such as a bond or promissory note, which contains the issuer's undertaking to pay the owner.

Omnibus customer account: an account in which the securities held by the participant on behalf of all (or at least several) of its customers are kept. See also proprietary account, segregation.

Participant: a party, which participates in a system. This generic term refers to an institution which is identified by the system and is allowed to send transfer instructions directly to the system or which is directly bound by the rules governing that system.

Paying agent: an institution that, acting on behalf of an issuer, makes payments to holders of securities (e.g. payments of interest or principal).

Payment: the satisfaction and discharge of a monetary obligation by the debtor's final transfer of a claim on a party agreed to by the creditor. Typically, the party is a central bank or a commercial bank.

Position netting: the netting of instructions in respect of obligations between two or more parties, which neither satisfies nor discharges those original obligations. (Also referred to as payment netting in the case of payment instructions).

Pre-matching process: process for comparison of trade or settlement information between counterparties that occurs before other matching or comparison procedures. Generally, pre-matching does not bind counterparties as matching can do.

Principal risk: the risk that the seller of a security delivers a security but does not receive payment or that the buyer of a security makes payment but does not receive delivery. In this event, the full principal value of the securities or funds transferred is at risk.

Proprietary accounts: an account in which a participant holds only those securities it is holding on its own behalf (as opposed to those securities it is holding on behalf of its customers). See also omnibus customer account, segregation.

Provisional transfer: a conditional transfer in which one or more parties retain the right by law or agreement to rescind the transfer.

Real time: the processing of instructions on an individual basis at the time they are received rather than at some later time.

Registration: the listing of ownership of securities in the records of the issuer. This task is often performed by an official registrar/transfer agent.

Replacement cost risk: the risk that a counterparty to an outstanding transaction for completion at a future date will fail to perform on the settlement date. This failure may leave the solvent party with an unhedged or open market position or deny the solvent party unrealized gains on the position. The resulting exposure is the cost of replacing, at current market prices, the original transaction.

Repurchase agreement (repo): a contract to sell and subsequently repurchase securities at a specified date and price. Also known as an RP or buyback agreement.

Rolling settlement: a situation in which a settlement of securities transactions takes place each day, the settlement of an individual transaction taking place a given number of days after the deal has been struck. This is in contrast to a situation in which settlement takes place only on certain days – for example, once a week or once a month – and the settlement of an individual transaction takes

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place on the next settlement day (or sometimes the next but one settlement day) following the day the deal is struck.

Same-day funds: money balances that the recipient has a right to transfer or withdraw from an account on the day of receipt.

Securities borrowing and lending programme: a facility whereby a loan of securities is made to facilitate timely fulfilment of settlement obligations.

Securities depository: see central securities depository (CSD).

Securities settlement system (SSS): a system in which the settlement of the securities takes place. Often the SSS is a CSD.

Segregation: optional or compulsory separation of the securities held by a participant on its own behalf from those held on behalf of its customers. See also omnibus customer account, proprietary account.

Self-collateralizing: an arrangement whereby securities being transferred can be used as collateral to secure risks involved in the transfer process.

Settlement: the completion of a transaction, wherein the seller transfers securities or financial instruments to the buyer and the buyer transfers money to the seller.

Settlement date: the date on which the parties to a securities transaction agree that settlement is to take place. The intended date is sometimes referred to as the contractual settlement date.

Settlement interval: the amount of time that elapses between the trade date (T) and the settlement date (S). Typically measured relative to the trade date, e.g. if three days elapse, the settlement interval is T+3.

Settlement risk: general term used to designate the risk that settlement in a transfer system will not take place as expected. This risk may comprise both credit and liquidity risk.

Sub-custodian: where one custodian (e.g. a global custodian) holds its securities through another custodian (e.g. a local custodian), the latter is known as a sub-custodian.

Substitution: the process of amending a contract between two parties so that a third party is interposed as an intermediary creditor/debtor between the two parties and the original contract between the two parties is satisfied and discharged.

Systemic risk: the risk that the inability of one institution to meet its obligations when due will cause other institutions to be unable to meet their obligations when due.

Trade date: the date on which a trade/bargain is executed.

Trade-for-trade (gross) settlement: a settlement in which a number of transactions between counterparties are settled individually.

Trade matching: see matching.

Trade netting: a legally enforceable consolidation and offsetting of individual trades into net amounts of securities and money due between trading partners or among members of a clearing system. Netting of trades, which is not legally enforceable is position netting.

Transfer: an act, which transmits or creates an interest in a security, a financial instrument or money.

Unwind: a procedure followed in a certain clearing and settlement systems in which transfers of securities and funds are settled on a net basis, at the end of the processing cycle, with all transfers provisional until all participants have discharged their settlement obligations. If a participant fails to settle some or all of the provisional transfers involving that participant are deleted from the system and the settlement obligations from the remaining transfers are then recalculated. Such a procedure has the effect of allocating liquidity pressures and losses from the failure to settle to the counterparties of the participant that fails to settle. Unwinds can be distinguished from debits to securities accounts that do not imply the original transfer is rescinded (e.g. in cases where securities are discovered to be forged or stolen).

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Variation margin: the amount which is paid by a counterparty to reduce replacement cost exposures resulting from changes in market prices, following the revaluation of securities or financial instruments that are the subject of unsettled trades.

Zero-hour rule: a provision in the insolvency law of some securities whereby a bankruptcy or similar procedure declared by a court during the day is considered to have been declared at 0.00 a.m. of the same day. This generally has the effect of retroactively rendering ineffective all transactions of the closed institution that have taken place after 0.00 a.m. on trade date.