Title: General description of trading on the capital market

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GENERAL DESCRIPTION OF TRADING ON THE CAPITAL MARKET

1. LEGAL BASIS

The core legal regulation of the capital market is based on four acts of law, namely:
1) the Act on Capital Market Supervision[1],
2) the Act on Trading in Financial Instruments[2],
3) the Act on Public Offerings, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies[3],
4) the Act on Financial Market Supervision[4].

The Act on Capital Market Supervision primarily regulates audit proceedings and preliminary investigations, along with certain supervisory powers of the Polish Financial Supervision Authority (the "FSA" or the "Authority"). It also includes certain regulations specifying the purpose and tasks of the Authority, the scope of supervision and the division regarding the exchange of information between the Authority and the supervisory bodies operating in other countries.

The Act on Trading in Financial Instruments sets out the methods, the rules and the conditions for commencing and conducting business involving trading in securities and other financial instruments, the rights and obligations of entities participating in such trading, and the supervision thereof. The glossary of the act contains the core definitions for the capital market, including mainly the definition of financial instruments (comprising the definition of securities within the meaning of the act), of the money market, and the alternative system of trading, underwriting etc. The Act on Trading in Financial Instruments also constitutes the basis of the normative division of financial instruments trading into secondary and primary trading. It regulates issues related to the functioning of the regulated market (the stock exchange and the over the counter (OTC) market) and also introduces a prohibition on market manipulation and specifies established market practices. In addition, the legislation also regulates the National Depository for Securities and issues related with participating in securities trading (the business activity of investment companies, brokerage houses, banks

[1] The Act of 29 July 2005, Journal of Polish State Law No. 183, item 1537, as amended, hereinafter referred to also as the "ACMS".

[2] The Act of 29 July 2005, Journal of Polish State Law No. 183, item 1538, as amended, hereinafter referred to also as the "ATFI".

[3] The Act of 29 July 2005, Journal of Polish State Law of 2009, No. 185, item 1439, as amended, hereinafter referred to also as the "APO".

[4] The Act of 29 July 2005, Journal of Polish State Law of 2009, No. 157, item 2006, No. 157, item 1119, as amended, hereinafter referred to also as the "AFMS".

performing brokerage business and other foreign entities conducting such business activity), including the types of participation, i.e. the activities of custodian banks and investor clubs. The act also regulates the compensation scheme constituting collateral for investors' interests, as well as issues related to access to information of a special nature (e.g. classified information) and the rules of its protection.

The third of the acts listed above regulates three essential issues, namely:

1) the rules and conditions for carrying out a public offering of securities and for seeking the admission and introduction of securities or other financial instruments to trading on a regulated market,
2) the obligations of issuers of securities and other entities participating in trade in such securities or other financial instruments, and
3) the consequences of obtaining the status of a public company, as well as special rights and obligations relating to holding and trading in shares in such companies[5].

The last of these acts, despite its title, is legislation establishing the state system and constituting the legal basis of the FSA. The acts do not address all the issues of the law on capital markets. The interdisciplinary, complex and multi-faceted nature of this market prevent its comprehensive and monolithic regulation. The prime legal act supplementing the functions of the basic provisions of law regulating the capital market is the Act on Investment Funds[6], but the *sensu largo* sources of this area of law include also the Commercial Companies Code[7], the Bonds Act[8], the Mortgage Bonds and Mortgage Banks Act[9], the Act on the Supplementary Supervision of Credit Institutions, Insurance Undertakings, Reinsurance Undertakings and Investment Firms in a Financial Conglomerate[10], and the Act on the Organisation and Operation of Pension Funds[11]. In addition to the legal acts regulating the functioning of the capital market at a statutory level, including the operations of the Polish Financial Supervision Authority, there are also numerous executive acts, of which the Regulations of the Minister of Finance have priority.

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[5] For a wider discussion of the new regulations included in three new acts see: Nowe regulacje rynku kapitałowego – najważniejsze zmiany i ich konsekwencje dla uczestników rynku *(New Regulations of the Capital Market – the Most Important Amendments and Their Consequences for the Market Participants)*, Warsaw 2005, Materials of Securities and Exchange Commission (KPWiG) (currently FSA); A. Chłopecki, *Public Trading and Financial Documents – Redefining Basic Terms of the Capital Market Law*, "PPH" 2005, No. 11, p. 38; K. Wojciechowska, *New Legal Regulation in the Capital Market Law – the Main Amendments*, "Edukacja Prawnicza" 2006, No. 2, p. 25.

[6] The Act of 27 May 2004, Journal of Polish State Law No. 146, item 1546, as amended, hereinafter referred to also as the "AIF".

[7] The Act of 15 September 2000, Journal of Polish State Law No. 94, item 1037, as amended, hereinafter referred to also as the "CCC".

[8] The Act of 29 July 1995, Journal of Polish State Law of 2001 No. 120 item1300 (uniform text).

[9] The Act of 29 August 1997, Journal of Polish State Law No. 140, item 940, as amended.

[10] The Act of 15 April 2005, Journal of Polish State Law No. 83, item 719, as amended, hereinafter referred to also as the "Act on Supplementary Supervision".

[11] The Act of 28 August 1997, Journal of Polish State Law of 2004, No. 159, item 1667, as amended.

2. LISTING A COMPANY (PUBLIC OFFERING) AND ADMITTING SECURITIES INTO OFFICIAL TRADING

As an issuer interested in gathering funds through issuing new financial instruments (e.g. shares as securities) on the capital market, a joint-stock company must make a public offer for the acquisition of its financial instruments. Such an offer is usually carried out in connection with increasing the company's share capital, as it refers to the issue of new shares[12]. Making such an offer is preceded by a complicated process comprising a range of various activities, both internal (e.g. adopting resolutions of the competent corporate bodies, such as a resolution of the General Shareholders Meeting on increasing the share capital), and external (e.g. concluding agreements on servicing the issuer during the process, with an investment company, with an auditor, with an investment advisor, with a legal counsel and with an advertising agency).

The preparation of a public offering requires the issuer's legal and economic standing to be established[13], and the offer itself must be analysed, including the choice of financial instrument subject to the public offering, along with the conditions of its acquisition[14]. An entity conducting stockbrokerage activity (an investment company) and an auditor are the two necessary facilitators in these proceedings, as they are obligatory by law. An investment company usually participates in preparing the company to be listed from the very beginning of the process, i.e. from developing the strategy of entering the regulated market (the issue programme)[15], through developing and drafting information documents (the issue prospectus), the procedure of approving the issue prospectus by the PFSA, and finally, performing and settling the offering and listing the company for trading[16]. An investment company also finally offers the financial instruments of the issuer on the market. Therefore, the investment company tends to be referred to as the issuing house. At the same time, the participation of an auditor in the process of listing the company is intended to ensure that the financial information made public in the company's information documents is true and fair, especially the information

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[12] A company may adopt various strategies of entering the market (to be listed). Its public offer may comprise, for instance, the issue of new shares (the company receives new funds for the share capital this way), the public sale of already existing shares (persons entitled to benefit from shares may in this way dispose of shares they hold, either for profit or to exit the company), listing shares on the stock exchange without a public issue (usually to increase the company's prestige), or a compilation of these possibilities. In addition to shares, a company may also publicly offer convertible bonds or other financial instruments. See R. Pastusiak, *Enterprise on Capital Market. Stock Exchange Operations on Public and Private Market*, Warsaw 2010, p. 68 *et seq*.

[13] Given the importance of a proper assessment of the company's financial and legal standing, the audit process should be performed with the utmost diligence. Therefore, it is referred to as due diligence.

[14] Also arrangements regarding the time limit for a public offering, the amount and value (issue price) of the offered shares, as well as the group of addressees of this offering (the "offerees"), are extremely important.

[15] Including also establishing the structure of the issue, creating book building, the issue price for the offered financial instrument etc.

[16] An investment company cooperating with a particular issuer is also referred to as the issue sponsor. This term may be misleading as it is not about sponsoring the issue, but about maintaining the register of subscribers of the new issue of shares offered within the initial public offering or within primary trading. The maintained register becomes part of the depository-settlement system, upon the registration of securities in the KDPW (Article 4 Paragraph 2 of the ATFI).

included in the issue prospectus, which forms the main document based on which investors will make their investment decisions.

Gathered and confirmed information is included the issue prospectus (or in another document performing a similar function, e.g. a memorandum of information[17])[18], which is subject to the approval procedure by the Polish Financial Supervision Authority prior to being published[19]. The decision on approving the issue prospectus is generally issued by the PFSA within 10 business days from the date of filing an application. However, if the issue prospectus refers to the securities of an issuer who has never offered any securities issued and subscribed so far in any public offering, and if these securities have not been admitted to trading on the regulated market, then the PFSA issues its decision within 20 business days from the date of filing the application. If the issue prospectus does not meet the requirements set out by the provisions of law, if the submitted documentation is incomplete, or if additional information must first be obtained, within the scope necessary for approving the issue prospectus, then the PFSA may demand that the information published in the issue prospectus be supplemented or changed, or that other documents and information regarding the financial or legal standing of the issuer be presented or included in the issue prospectus[20]. In addition, the PFSA may demand that additional information be included in the issue prospectus. The application to approve the issue prospectus may be refused if the prospectus does not meet the requirements specified by the provisions of law with regards to its form or content. In addition, upon the approval of the issue prospectus by the PFSA, the issuer is obliged to permanently and immediately inform the PFSA about any events or circumstances that could have a material effect on the perception of the financial instruments offered publicly by the issuer[21].

Upon the approval of the prospectus, the issuer performs the public offering and collects subscriptions for the new issue of shares. Before making a public offering, it is in the interest of the issuer, but also to the benefit of investors, to announce the scheduled issue. Announcing information about the issue is referred to as the issue promotion. Securities offered by the issuer, as with any other commodity, should be advertised in order to drum up interest among investors in the issuer, in the securities being offered and in the content of the offer. The issuer often conducts market research to gauge interest in its offer while drafting the offer content, particularly the price of shares, the

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[17] The memorandum of information is issued in the situations described in Article 7 Paragraph 3 item 5 a) and b) and in Paragraph 4 items 4 and 5 of the APO.

[18] The obligation to prepare, approve and make public the issue prospectus exists, as a rule, in the case of an initial public offering, a public offering and in proceedings on admitting securities to trading on the regulated market.

[19] According to Article 410 Paragraph 4 of the CCC, an application for approval of an issue prospectus or information memorandum (or an application for confirmation that the information included in the memorandum complies with the information required in the issue prospectus) cannot be filed later than four months after the date of adopting a resolution on increasing the share capital.

[20] The PFSA may make such a demand towards the issuer, the selling party, an entity authorised to audit financial statements who performed such an audit of financial statements of the issuer published in the issue prospectus, the entity described in Article 27 Paragraph 1 item 3 of the APO, the parent company or a subsidiary of the issuer or the selling party, members of management bodies of the issuer or the selling party.

[21] In the form of annexes to the prospectus that the issuer must submit to the PFSA within 24 hours from the event, or from the occurrence of circumstances for the purpose of their approval.

number, the date of commencing subscriptions for shares, and the target group that the offer is addressed to. This activity is referred to as the book building process. During this process, the issuer tests potential investors – checking the price they would be ready to pay for its future securities, and the amounts they would be interested in buying. Based on this, the issuer receives the information allowing it to better draft the final content of the offer (including in particular the price of the shares). As part of the book building process, the issuer may apply various loyalty programmes during the research, in return for participating in it, and may grant specified preferences when offering securities to the research participants.

Before commencing a public offering, the issuer may also consider the need to conclude underwriting agreements[22]. These agreements ensure that the issue of securities will be effective[23]. The Capital Market Law differentiates two types of underwriting agreements: firm commitment underwriting and standby underwriting. The first one includes the underwriter (known as the firm commitment underwriter) who[24] undertakes towards the issuer (or the selling party)[25] to acquire (subscribe), on its own account, all or part of the securities of a specific issue, offered exclusively to this entity with a view to reselling them in the public offering. Under a standby underwriting agreement, however, the underwriter (known as the standby underwriter)[26] undertakes towards the issuer (or the selling party) to acquire (subscribe), on its own account, all or part of the securities offered in the public offering that were not subscribed for during the subscription period. Both these types of agreements, therefore, assure the issuer (or the selling party) that the securities they are offering will be acquired in full, so the issue will be successful. As long as the firm commitment underwriting involves subscribing for all the securities (100 per cent of the issue) by the firm commitment underwriter, the standby underwriting constitutes some kind of "supplementing interest in the issue" up to 100 per cent. If investors fail to subscribe for all the securities offered by the issuer, the standby underwriter will subscribe for the remaining part. What is important, the agreement concluded by the issuer for firm commitment underwriting should include the possibility for the firm commitment underwriter to dispose of the right to subscribe for the securities. Disposing of this right by the underwriter is considered as primary trading, even though it is actually secondary trading (investors buy securities, but not from the issuer). In addition, offering the sale of shares subscribed for in execution of this right is considered as primary trading when a registry court enters the increase of share capital of the issuer into the commercial register.

Upon announcing a public offering which involves providing at least 150 addressees, or an unspecified addressee, with sufficient information on the securities being offered

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[22] See more: M. Pawełczyk, *Underwriting in Public Company*, "Jurysta" 2002, No. 10; Idem, *Underwriting in a Public Company,* Katowice 2005.

[23] Selling securities under such an agreement is performed through an investment company.

[24] Only a bank, an investment company or a foreign investment company, or a consortium of such entities, may act as the firm commitment underwriter. In the case of a consortium, each entity acting as a consortium member is also considered as the firm commitment underwriter.

[25] The selling party is the holder of securities who makes a public offering.

[26] Only an investment company, an investment fund, an open pension fund, a bank, insurance company, a Polish or foreign financial institution with its registered office in an OECD member state, or subject to OECD, or a consortium of such entities may act as a standby underwriter. In the case of a consortium, each entity acting as a consortium member is also considered the standby underwriter.

and the terms and conditions of their acquisition in order to enable an investor to decide whether or not to purchase these securities, the investment company is in charge of the subscription for securities offered by the issuer. The process of subscribing for shares in a company (the shares subscription) cannot exceed three months and is subject to the provisions of the Commercial Companies Code (Article 434 of the CCC *et seq*.).

Upon the subscription closing and for all the shares being subscribed for, the issuer files an application to register the increased share capital in the National Court Register[27]. According to Article 431 Paragraph 4 of the CCC, a resolution on increasing the share capital cannot be notified to the registry court more than twelve months (in the case of a new issue of shares subject to a public offering covered by an issue prospectus or information memorandum) after the date of the respective approval of the issue prospectus (or information memorandum) and no later than one month after the date of assigning shares. Newly issued shares are created at the moment of the registry court's decision on the share capital increase becoming valid. However, as mentioned above, a share, as an object of public trading on the regulated market, will be created at the moment of being registered in the National Depository for Securities[28].

Every security that is subject to a public offering or is admitted to trading on the regulated market must be dematerialised. Therefore, pursuant to Article 5 Paragraph 4 of the ATFI (and Paragraph 5 with regards to financial instruments other than securities), the issuer of securities is obliged to conclude an agreement with KDPW S.A. on registering the securities in the depository for securities. The issuer's securities are entered into special KDPW accounts (issue accounts). At the moment of concluding the agreement, the shares are subject to dematerialisation, while any entries regarding these securities made in connection with their subscription or sales in primary trading or under an initial public offering by an investment company (namely by entities acting as stockbrokers or by custodian banks) are also considered securities accounts, as long as they identify the entities entitled to rights under the securities. At the moment of dematerialising at least one share, the company that issued it becomes a public company. According to Article 4 Paragraph 1 item 2 of the APO, a public company is a company in which at least one share is dematerialised within the meaning of the Act on Trading in Financial Instruments[29].

At the same time, the rights from dematerialised securities arise at the moment when they are first registered on the securities account, and the owner of this account is entitled to these rights.

The next stage in the procedure of introducing shares into public trading is proceeding before the company organising and performing trading on the particular market (the stock exchange market or the OTC market). Two sub-stages should be distinguished

[27] Within 14 days from the date of completing the subscription or of the sale of securities subject to the public offer, or of admitting the securities to trading on the regulated market (or their introduction to the alternative trading system), the issuer or the party selling the securities is obliged to inform the PFSA about this fact. Based on this, the Authority enters the securities to its register (the PFSA maintains a register of securities subject to public offerings, as well as securities and financial instruments other than securities, admitted for trading on the regulated market or entered into the alternative trading – except for securities issued by the State Treasury and the National Bank of Poland).

[28] Hence the specific dualism of regulations – the Commercial Companies Code and the Capital Market Law (in particular the Act on Trading in Financial Instruments) with regards to creating a share as a security.

[29] Except for a company that has shares registered under Article 5a Paragraph 2 of the ATFI.

in this procedure. The first stage involves admitting the company to public trading, the second involves introducing its securities to trading. Admitting means that the company's securities meet the requirements specified in the regulations binding on the market the company aspires to be listed on (e.g. the Stock Exchange Regulations)[30]. On the other hand, being introduced onto the market means establishing the start date for listing the issuer's securities on the specified market resulting in the legal and actual appearance of the securities in trading (the company's debut). It should be noted, additionally, that the legal nature of both solutions, similarly to the legal nature of their basis (the applicable regulations of companies operating a regulated market), causes many doubts due to their impact on third parties. The stock exchange management board adopts a resolution on admitting financial instruments to stock market trading within 14 days from the date of the interested company (the issuer) filing the relevant application. If the filed application is incomplete, or if additional information must first be obtained, the stock exchange management board or supervisory board may demand that the application be supplemented, or that information be presented allowing an assessment of whether the financial instruments subject to the application meet the criteria and conditions for being admitted to trading on the particular market. The stock exchange management board will refuse to admit financial instruments to stock market trading if the above criteria and conditions are not met[31]. In the event of a refusal to admit securities, the applicant is entitled to appeal against the decision of the stock exchange supervisory board within the time limit specified in the stock exchange regulations[32]. The appeal is reviewed within a month from being submitted. A resolution of the stock exchange supervisory board denying the appeal may be brought before the court competent for the registered office of the company operating the stock exchange market within 14 days from the date of obtaining information on the resolution, if the refusal breaches the provisions of the stock exchange regulations[33]. A court decision resulting from a statement of claim replaces the resolution on admitting financial instruments to the stock market trading[34].

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[30] As described above, the financial instruments may be admitted to trading provided that the relevant information document on them was prepared, approved by the competent supervision authority, or a relevant information document was prepared with the document equivalence within the meaning or the Act on Public Offerings was stated by the competent supervision authority, unless preparing, approving or stating the equivalence of an information document are not required, with their unlimited marketability and with no bankruptcy or liquidation proceedings pending against the issuer. Analogical requirements apply on the OTC market. The stock exchange management board is not required to adopt a resolution on admitting to trading financial instruments issued by the State Treasury or the National Bank of Poland. Financial instruments of these issuers are considered admitted to stock exchange trading at the moment of the issuer filing an application for admittance and entering these instruments to trading.

[31] A refusal of admission must be properly justified.

[32] Article 23 of the Stock Exchange Regulations stipulates that it may take place within five session days from serving the resolution. The same time limit is set out in the trading regulations for the OTC market (Article 8 of the Regulation).

[33] A repeated application for admittance to stock exchange trading of the same financial instruments may be filed not earlier than six months after the date of being serving the resolution, and in the case of lodging an appeal, from the date of serving the repeated denial resolution.

[34] The admission to trading on the regulated market is regulated in a similar manner to the one described above.

Financial instruments are introduced and admitted to trading on the basis of an application of the interested company (the issuer). An application to introduce securities (i.e. the company's debut on the market) should be filed with the management board of the stock exchange company (stock exchange market) within six months from the date of receiving the decision on the admission to trading. After that time, the stock exchange management board may repeal the decision on admission[35]. Financial instruments may be introduced to stock exchange trading in the ordinary procedure or through a public offering for sale. Introducing financial instruments to stock exchange trading in the ordinary procedure is requested by the issuer in an application, indicating in particular the code assigned to the instruments under which they are registered in the depository for securities. Upon filing the application, the management board of the company operating the particular market introduces the financial instruments covered by the application into stock exchange trading, specifying in particular the stock exchange session of the first listing.

Financial instruments are introduced through a public offering on the basis of a sale offer made by a stock exchange member (e.g. an investment company). Financial instruments may be introduced through a public offering if the public offering includes at least 10 per cent of the financial instruments covered by the application for admission, or if the offering value exceeds PLN 4,000,000 in the case of financial instruments entered into trading on the prime market, or PLN 1,000,000 in the case of financial instruments introduced into trading on the alternative market. The trade participants are notified about the introduction of the financial instruments, while in the case of public offerings the notification should take place within one hour after the end of a trading session on a trading day, and no later than one hour after the end of trading on a trading day preceding the introduction date.

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[35] If a company with its shares already admitted to trading does not introduce stock exchange trading with its new issue shares within six months from the date of completing the subscription of these shares, or by the date when their disposing of was limited, then it is obliged to publish information on the reasons for this decision.