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WARRANT COMPENSATION SCHEME  
NEEDS ANALYSIS REPORT  
FOR THE STATE PROPERTY AGENCY

30 January 1992

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## **1. INTRODUCTION**

### **1.1 Background**

The Government of Hungary is in the process of changing from a command economy to a free market economy. The program involves the transfer of ownership of assets from the state sector to the private sector.

This transfer of assets includes a scheme for compensating those citizens whose assets were transferred to the state, without payment, by previous governments. Thus, the current government is to acknowledge debts to certain citizens through the issue of warrants, defined in law as "compensation coupons".

In accordance with the law, applications for compensation had to be made by 16 December 1991. Successful applicants will have available a number of ways to use their compensation warrants, and further enabling legislation has been drafted. For example, the use of warrants includes participation in privatization issues, purchase of property and the purchase of annuities.

This initial compensation scheme may be followed by a further measure of compensation, the subject of which is currently under debate in Parliament.

### **1.2 Aim of the Study**

Under the compensation law, the State Property Agency (SPA) is responsible for the administration of the compensation scheme once the warrants have been issued.

To assist them to carry out this responsibility the SPA requested the U.S. Agency for International Development (USAID) to support the establishment of the Warrant Administration Unit (WAU). This was part of the technical assistance on privatization already being delivered to the SPA under the USAID program.

The SPA had not systematically defined the needs of the proposed organization, and DRT International were commissioned to conduct a needs analysis to provide a clear definition of what type of support was needed.

The aim of the study was therefore to review the requirements of the compensation scheme, identify the key needs, problems to be addressed and the expected role and function of the WAU. This included examination of the WAU's role within the overall framework of the scheme.

### **1.3 The Study Team**

The study was conducted by a team of consultants from Deloitte & Touche, DRT Hungary (both DRT International member firms), other DRT International firms and from a subcontractor, American Manufacturers Export Group (AMEG).

The team comprised financial instruments specialists, financial analysts, and training and communications specialists. The needs analysis was carried out in Budapest between November 1991 and January 1992. The team reported to the SPA's Privatization Advisor, funded by USAID under the Economic Restructuring and Privatization Project for Central and Eastern Europe.

## 2. MANAGEMENT SUMMARY

This report is the result of a needs analysis carried out on behalf of the State Property Agency (SPA) by DRT International. It addresses the proposed role and functions of the Warrant Administration Unit (WAU) in administering the compensation scheme, and, due to the number of organizations involved in the scheme, it also examines the context in which the unit will operate.

As a result, we present our key findings and recommendations for the WAU and, where appropriate, for the scheme as a whole. This is followed by an Action Plan for the tasks that need to be completed before the first major issue of warrants in March.

### 2.1 Responsibilities

The Compensation Law imposes duties and responsibilities on a number of institutions, in particular, responsibility for the issuing of warrants to OKKH, and responsibility for the administration of the scheme, as well as exchanging warrants for shares to the SPA.

The scheme is very complex but no provision has been made for coordinating the activities of all the organizations involved; no one person or body has been given overall responsibility for the scheme.

*There is an immediate need to appoint a coordinator, a person with overall responsibility for driving the scheme and ensuring the active cooperation of all parties involved. We recommend that further external funding be contingent upon this coordinator being appointed.*

### 2.2 Coordination

To fulfil its duties in administering the warrant scheme the WAU needs to be able to balance the availability of investment opportunities with the flow of warrants issued, for which it needs the ability to monitor and evaluate the progress of the scheme. However, none of the organizations involved has authority or responsibility for the overall coordination of the scheme.

Without this overall coordination there is no forum in which the impact of deviations from a consolidated and coherent plan can be assessed, in which the options available can be discussed, or agreed courses of action determined.

We conclude therefore that, for the sake of the overall scheme, there needs to be a means of:

- consolidating planning information and actual results;
- directing the warrant scheme to operate in the most effective manner through bringing the organisations involved together on a formal basis.

*To address this vital need we propose the establishment of a group of representatives drawn from the organizations involved, to coordinate operations and provide a forum for formalizing the flow of information. We have called this group the Operational Steering Committee (OSC). The OSC should be chaired by the scheme's coordinator and serve as a vehicle for providing him with essential planning and operational information. It would also alert the Coordinator to issues that could not be resolved within the OSC, for example questions of policy.*

### 2.3 Planning

There is a distinct lack of real planning by the organizations most involved in the scheme. Plans for the issue or dispensation of warrants represent more a statement of intent than a calculated assessment of what can be achieved and when. As a result plans that have been announced have changed, sometimes dramatically, even during the course of our study; for example the start date for issuing warrants has slipped from 15 January to an unspecified date in March. Similarly, very little detailed information exists within the SPA on the investment opportunities for warrant holders.

*We propose that the WAU undertakes a project to define in detail the information it requires from the rest of the SPA and the other institutions. We further propose that the WAU sets up a computerized operational model to process this information.*

*The WAU should then provide supporting information to the OSC for use in evaluating the progress of the scheme and making recommendations to the coordinator.*

### 2.4 Operation of the WAU

To perform its role the WAU will need technical, analytical and business skills to conduct its operations and advise on action necessary for the smooth running of the scheme. Currently the WAU comprises just one person, and does not have a budget for additional staff.

*We propose an organizational structure with, initially, a further two staff reporting to the WAU head. External advisors may be used to bridge gaps in local skills until these skills are successfully transferred. We also suggest a specific skill development program for the WAU be designed in conjunction with the SPA's training program.*

### 2.5 Public Relations

The credibility of the warrant scheme will depend to a large degree on managing the expectations of the public and warrant holders and their perception of how successful the operation has been. The role of a carefully planned Public Relations (PR) campaign in achieving this objective is therefore paramount; it must ensure that adequate information is made available, particularly to warrant holders, and the correct message is conveyed.

Experience with the warrant scheme so far shows that the whole subject of PR has been either largely overlooked or at best misunderstood. As a result negative publicity has emerged, threatening the acceptance of the scheme.

*We propose that the recently established Public Relations Task Force, which represents the major participants in the scheme, take formal steps to define, and obtain authorization for, a PR action plan. This should cover, as a priority, the initial launch of the scheme in March, followed by a PR plan for the continuing operation of the scheme.*

## 2.6 Action Plan

A number of tasks have been identified which must be completed before warrants are issued in mid-March, and for which external funding will be required to the extent of around \$150,000.

The tasks divide between those aimed at supporting the scheme as a whole and those which support the SPA in establishing the WAU.

Tasks supporting the whole scheme are:

- carrying out an initial Public Relations campaign;
- establishing fraud control procedures;
- developing an operational plan for the scheme.

Tasks directly supporting the WAU are:

- establishing WAU data requirements and collection procedures;
- producing an operational model for analyzing data on warrants issued and company assets available;
- developing a systems requirements plan for the WAU;
- defining job descriptions for the WAU, providing recruitment assistance and training for WAU staff;
- advising on accounting information needs of the WAU in reporting to the SPA.

Full descriptions of these tasks are contained in Appendix VI.

*The timeframe for carrying out this work, which is expected to take 4 to 6 weeks, is very limited. It is recommended that an immediate request is made for funding so they can be started as soon as possible.*

### 3. CONDUCT OF THE STUDY

#### 3.1 Approach

After an initial briefing meeting with the SPA, the DRT team defined the key information needs for the study, developed a project plan and arranged an extensive series of interviews. Interviews were conducted with SPA officials, officials from Government and private sector institutions and with attorneys who were instrumental in the writing of the compensation law. A complete list of those interviewed is included in Appendix I.

In addition the team reviewed:

- the compensation law and its translation, as well as a subsequent amendment and additional final and draft legislation covering the payment of annuities, mutual funds and the sale of land;
- news articles and television features about the compensation scheme;

Two interim documents were produced for the SPA during the progress of the needs analysis. The first, delivered within two weeks, defined the objectives of the scheme for discussion and approval, provided an overview of the provisions of the scheme (contained in Appendix II) and included a graphical illustration of the use of the warrants. It also identified a number of key issues that would need to be addressed during the study. The second document was a progress report delivered on the 19th of December, this provided an update on the investigations into the issues and raised a number of key concerns, including the lack of overall coordination of the scheme which had been raised earlier with the Managing Director of the SPA. We have updated this document and present it in Appendix III.

On 10 December, a presentation was given to the SPA Board of Directors to describe our approach, the findings to date and to raise with them the major concerns.

Following a paper written by a member of the team on the need for and method of conducting a Public Relations (PR) campaign, an initial meeting was held to review the paper and agree a way forward. The meeting brought together for the first time all the organizations involved in the warrant scheme, and, as a result, it was unanimously agreed to form a PR Task Force.

### 3.2 Major Issues

The major issues identified by the consulting team are presented in full in Appendix III. 15 major issues were identified, summarizing the context in which the Warrant Administration Unit would be operating. These key considerations in undertaking the needs analysis were categorized as those impacting:

- political objectives:
  1. The capacity and capability of the broker network;
  2. The coordination of public relations;
- economic objectives:
  3. The investment policy of implementing institutions;
  4. The capacity of the Budapest Stock Exchange;
  5. The consequences of heavy secondary market sales;
  6. How to counter or prevent heavy price falls;
  7. The ability of the privatization program to support the compensation scheme;
- operational issues:
  8. OKKH planning for the issue of warrants;
  9. Capability of the OKKH/Budapest Securities computer system;
  10. Availability of shares to cover the first tranche of warrants;
  11. Standards and controls within the brokerage system;
  12. Controlling the risk of fraud;
  13. Requirements for termination of warrants;
  14. How the WAU should be organized;
  15. Legal obligations of the institutions.

## 4. OVERVIEW OF THE SCHEME

### 4.1 Purpose

The purpose of the scheme is to issue warrants (instruments of government debt) to those eligible for compensation under Law XXV/1991. The warrants will be printed with a face value, having a nominal value which increases through accrued interest.

The interest period for all warrants commenced in August 1991, and interest will continue to accrue for a minimum of three years from the issue date with the payment of interest at 75 percent of the National Bank of Hungary's Basic Rate.

The warrants are to be used for exchange of assets from the state. The intent of the law was to stimulate the privatization process and provide restitution to those individuals who suffered property losses from the previous regime.

### 4.2 Objective

The overall objective of the scheme is to achieve credibility in the delivery of compensation according to the law. Achieving and maintaining this credibility has three main aspects, and these are described below.

#### *Political*

For the scheme to be credible those eligible must perceive that they are receiving fair compensation in accordance with the law. Thus, in a political context, the objectives will be to ensure that:

- those eligible for compensation have information which makes the scheme understandable;
- those eligible for compensation can take advantage of the options available to them;
- the organizations required (by law) to offer the options for usage of the warrants are ready to assist citizens in a fair and helpful manner.

#### *Economic*

The face value of the warrants to be issued is currently estimated at over HUF50 billion. The scheme must be managed in such a way as not to damage the economic interests of Hungary and its citizens, in order to do this the scheme must:

- minimize the cash flows resulting from the scheme, especially where the effect might result in worsening inflation or balance of trade. In practice this means encouraging a direct exchange of warrants for state assets;
- deliver compensation under the scheme within a limited timeframe alongside the privatization program, which must, in turn ensure that shares of an appropriate quality are available in sufficient numbers for the compensation scheme to operate.

### *Operational*

The credibility of the scheme is also dependent upon the administrative effectiveness of the SPA and other organizations involved. The objectives are:

- consistency with the political and economic objectives given above;
- low cost;
- simple to operate;
- easily understood (by all involved);
- minimal risk of fraud;

### **4.3 Description of the Proposed System**

In this section we describe how:

- warrants will be distributed following the processing of applications for compensation;
- warrants may be used by warrant holders.

This description is supported by the diagram in Figure 4-1, which illustrates the flow of warrants and compensation. The far left hand side of the diagram shows the role of OKKH in processing applications, the right hand side of the diagram showing the ten methods of using warrants.

#### *Distribution of Warrants*

OKKH, the Indemnification Office, has been set up specifically to receive and process applications, resolve claims, and manage the distribution of warrants. It functions independently of the SPA.

The steps for distributing warrants will be:

- the compensated person receives a decree from the OKKH indicating the compensation amount. The individual has the right to dispute the compensation amount. If he does, then he has to appeal to the OKKH and a hearing will be scheduled.

If the individual accepts the compensation amount, he will go to a local OTP branch or Budapest Bank office to exchange the decree for warrants;

- the person collects the warrants, which will be distributed in denominations of HUF1,000, 5,000, and 10,000. Additional information will be distributed to compensated persons to describe the use of the warrants. After receiving the warrants, the compensated person will be requested to complete a non-compulsory statistical form stating their intended use of warrants.

OVERVIEW OF WARRANT COMPENSATION SCHEME

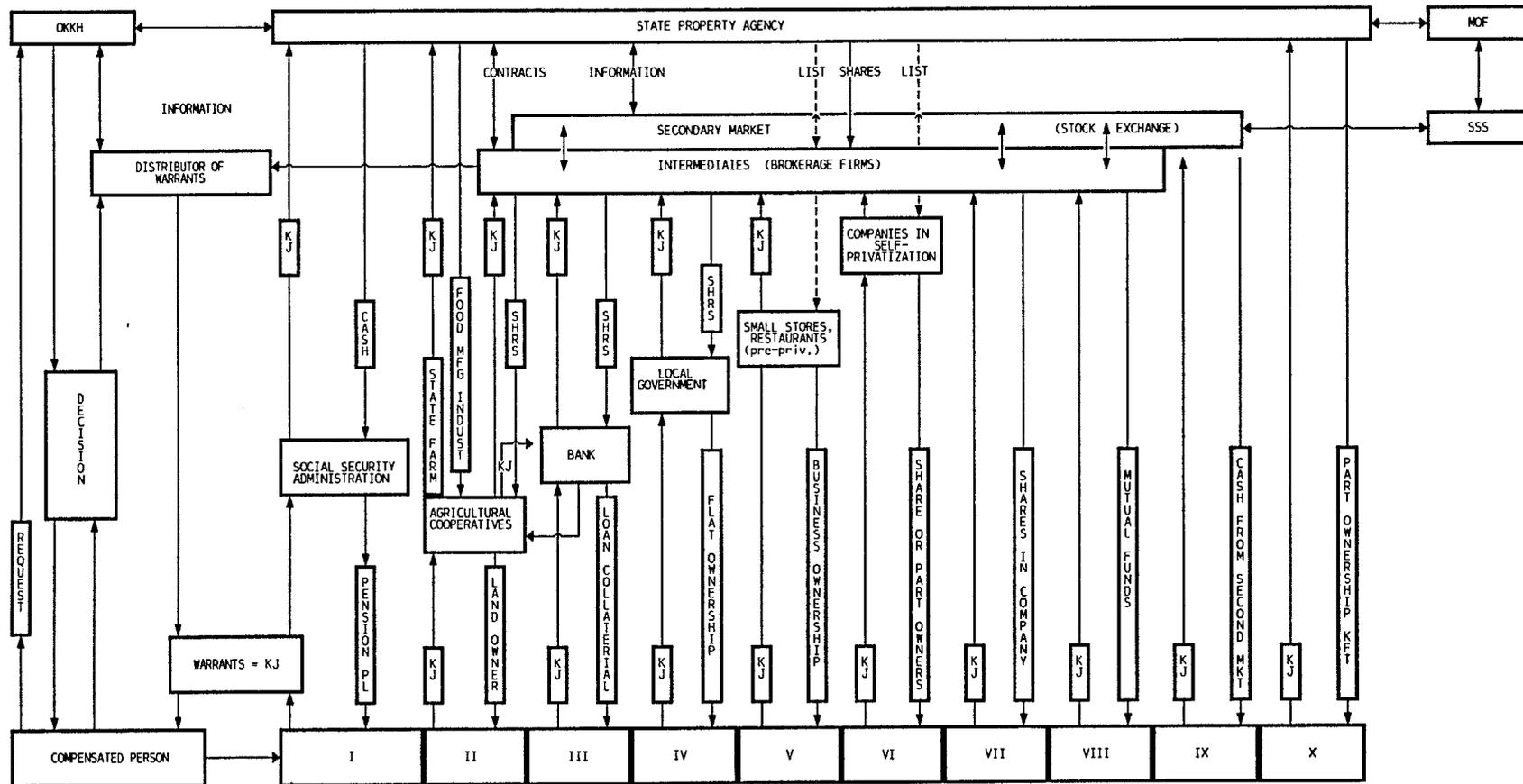


Figure 4-1

## *Using the Warrants*

In exchange for warrants, the compensated person will have the following ten options available:

### **I. Pension Plan**

Available to the original holder of the warrant.

The annuity will only be available to persons over the age of 65 and there will be other restrictions. The annuity will be calculated in accordance with the sex and age of the applicant and will be disbursed by the Social Security Administration using the proceeds of the SPA's privatization program.

### **II. Land Ownership**

Available to the original holder of the warrant.

Agricultural cooperatives must set aside a portion of their land for auction. The original bearer will be permitted to bid for the parcel of land and, after winning the auction, the warrant holder must put the land to agricultural use and not withdraw it from production for five years.

The privately held cooperatives receiving the warrants in this fashion will in time be able to use them to invest in food companies controlled by the SPA.

### **III. Banks**

Available to both the original and secondary holders of the warrants.

We have been advised that legally banks do not have to accept the warrants as collateral for loans. It has been speculated that banks may accept warrants from agricultural cooperatives in payment of loans in lieu of cash payments.

### **IV. Flats**

Available to the original holder of the warrants.

As stated by the compensation act, the local authorities must accept warrants at nominal value for the purchase of flats which have been made available for purchase. This option is only available to those individuals inhabiting the flat.

### **V. Business ownership through Pre-Privatization**

Available to both the original and secondary holders of the warrants.

Pre-Privatization is the auction of retail and catering outlets. If the local government founded the retail establishment, then up to 50% of the purchase price can be paid in warrants. If it was founded by the state, then the SPA may accept 100% of the purchase price in warrants. Privatization costs must be paid by the purchaser in cash.

## **VI. Business ownership through Self-Privatization**

Available to both the original and secondary holders of the warrants.

The law states that any company transformed after 15 August 1991 has to submit 10% of its share for warrants (20% for food production companies).

Self-Privatization occurs when State Owned Enterprises (SOEs) are sold to investors by privatization consultants and the SPA has the right to review the privatization consultants work.

Within the scope of the first phase of self-privatization, which includes small SOEs, the warrant holder will be permitted to purchase shares in the company.

The SPA will also accept warrants for the second phase of self-privatization but the amount or value of company shares to be exchanged for warrants has not yet been determined. This second phase will include mid-sized companies.

## **VII. Shares in Companies**

Available to both the original and secondary holders of the warrants.

This involves SPA companies which may be transformed into either an Rt (public company) or Kft (limited company).

The SPA will publish a monthly list of companies in which shares will be sold through a brokerage network and by public offer. The SPA currently expects to list the shares of at least four or five companies monthly with a value of HUF1 billion. A prospectus containing audited financial statements and outlining the activities of the company will be provided to potential investors.

## **VIII. Mutual Funds**

Available to both the original and secondary holders of the warrants.

Currently this option is not available. The law on Mutual Funds was promulgated recently and states that a certain percentage of assets must be publicly traded. Due to the limited number of publicly traded shares mutual funds may not exist until the latter part of 1992 or thereafter.

## **IX. Cash from Secondary Market**

Available to both the original and secondary holders of the warrants.

The compensation warrants will be listed on the Budapest Stock Exchange and also on the Over The Counter (OTC) market. Activities in both markets falls under the Securities Act and will therefore be regulated by the State Securities Supervisor (SSS).

## **X. "Business Parts" in Kfts.**

Available to both the original and secondary holders of the warrants.

Since Kfts are limited liability companies which do not issue shares, the court of registry will be provided by the SPA with a list of investors. As the process of changing the company's article of association is lengthy, the SPA will make these "business parts" available to the bearer of warrants with a minimum nominal value of HUF100,000.

#### 4.4 Volume Projections

##### *Availability of the Shares/Assets for Warrants*

The SPA, local governments, agricultural cooperatives and the social security administration are required by the compensation law to accept warrants. The enclosed table outlines the few statistics that are available on the current and planned supply of shares/assets for exchange of warrants.

The following explanations apply.

##### ■ **Shares held by the SPA:**

For the month of January, the SPA originally planned to have at least four companies available with a total share capital of HUF1.0 billion. These companies were chosen from the Asset/Portfolio Management Unit (APM) of the SPA. However, only one company was approved by the State Securities Supervisor (SSS) with shares of HUF360 million. During the month of February, three companies will be added to the list with shares worth HUF554 million, and during March, four companies worth HUF778 million.

The SPA anticipates having 4 to 5 companies with a total equity of 1.0 Billion HUF available monthly from April. These projections are contingent on the quantity of transformed companies, both in value and number, and the availability of audited financial statements, valuations, prospectus, and other financial information.

##### ■ **Self-Privatization Unit**

The first phase Self-Privatization includes approximately 400 small SOEs with the majority being transformed into Kfts. This process, started in November 1991, will operate for 18 months. Currently 21 companies have been sold; 172 are in the pipeline. Total equity available will be HUF25 billion. The first phase will accept up to 50% of the purchase price in warrants. At this time, the SPA has not determined the minimum investment accepted in warrants.

The second phase of Self-Privatization is currently being discussed by the SPA's Board of Directors and may be approved by April 1992. The second phase includes SOE that are considered "mid-sized" which can be transformed either into Kft or Rt companies. The SPA has not determined the total equity amount of the companies in the second phase but has estimated between HUF175 to 200 billion. It is planned that the program will operation for 36 months. No determination has been made as to the percentage of the sales price to be accepted in warrants.

**SPA - Supply side fulfilment of exchange of shares/property for warrants.**

(the amounts quoted are in million HUF.)

The amounts shown are new issues only.

	<u>January</u>	<u>February</u>	<u>March</u>	<u>April</u>	<u>May</u>	<u>June</u>	<u>July</u>	<u>August</u>	<u>September</u>	<u>October</u>	<u>November</u>	<u>December</u>
<b>Shares held by SPA (1)</b>												
- Rt's:	360	554	778	1,000+	1,000+	1,000+	1,000+	1,000+	1,000+	1,000+	1,000+	1,000+
- Kft's:	0	0	0									
<b>Self Privatization Unit</b>												
- 1st Phase (2)	700	700	700	700	700	700	700	700	700	700	700	700
- 2nd Phase (3)	0	0	0	970	970	970	970	970	970	970	970	970
<b>Pre Privatization Unit</b>												
- Founded by State	0											
- Founded by Local Government	0											
<b>Mutual Funds</b>												
					----- No estimates at this time -----							
- Shares in Companies	?	?	?	?	?	?	?	?	?	?	?	?
- Real Estate	?	?	?	?	?	?	?	?	?	?	?	?
<b>TOTAL</b>	?	?	?	?	?	?	?	?	?	?	?	?
Local Governments	?	?	?	?	?	?	?	?	?	?	?	?
Banks	?	?	?	?	?	?	?	?	?	?	?	?
Agricultural Cooperatives												
- Private Coops	?	?	?	?	?	?	?	?	?	?	?	?
- State Farms	?	?	?	?	?	?	?	?	?	?	?	?
Social Security Admin.	?	?	?	?	?	?	?	?	?	?	?	?
<b>TOTAL</b>	?	?	?	?	?	?	?	?	?	?	?	?
<b>GRAND TOTAL</b>	?	?	?	?	?	?	?	?	?	?	?	?

**OKKH Distribution**

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The OKKH issued HUF 24 million warrants in value in December 1991. The next issue of warrants will be in March 1992.

(1) Based on estimates supplied by Kalman Kovacs, SPA

(2) The average equity available in the first phase of Self-Privatization is 25 Billion HUF available over 18 months. The SPA may accept 50% of the purchase price in warrants. Therefore, 25 Billion HUF over 18 months equals 1.4 Billion HUF per month. If the SPA accepts 50% in warrants, the total available for warrants will be 694 million HUF per month.  
Source: Self-Privatization Unit of SPA.

(3) These are the estimates from the SPA for the second phase. The second phase has not been approved at this time. The estimated average equity available in the second phase of Self-Privatization ranges between 175 to 200 Billion HUF available over 36 months. The SPA may accept 50% of the purchase price in warrants. Therefore, at a minimum, 175 Billion HUF over 18 months equals 9.7 Billion per month. If the SPA accepts 10% in warrants, the total available for warrants is 970 million HUF per month.

## ■ **Pre-Privatization**

Pre-privatization is a continuous process. The SPA is very active in auctioning small retail stores to individuals. Within the scope of Pre-Privatization, the founder of the company determines the use of warrants, i.e. if the company was founded by the Central Government, as opposed to a local government, the SPA will accept 100% of the proceeds in warrants. If a local government was the founder, then 50% of the proceeds can be paid in warrants to the SPA and the remaining funds have to be in cash or E-Hitel Loans.

At the current time, the SPA is gathering information on the use of warrants for payment on Pre-Privatization since the warrants compete with subsidized loans (E-Hitel loans) for payment. The SPA has not determined the actual amount of warrants to be used in Pre-Privatization.

## ■ **Mutual Funds**

The Mutual Fund law recently passed requires portfolios to hold a certain percentage of publicly traded domestic securities. At present, there are no plans to create any mutual funds.

In exchange for warrants, the following assets are planned by institutions other than the SPA:

### ■ **Local Authorities**

Local authorities have a legal commitment to accept warrants for flats being put up for sale. However there are no projections of the likely volume or value of these flats becoming available.

### ■ **Banks**

Banks have considered accepting warrants from agricultural cooperative in lieu of cash loan payments. However, they have no legal obligation to do this and have not yet indicated the percentage or value of warrants they may accept.

### ■ **Agricultural Cooperatives**

By law, the agricultural cooperatives will accept warrants for parcels of land and will be able to purchase, from the SPA, company shares. The Ministry of Agriculture and the Association of Agricultural Cooperatives (MOSZ) are the forums for the agricultural cooperatives. No immediate plans are available.

### ■ **Social Security Administration**

As stated in the law, the Social Security Administration will make life time annuities available to compensated persons. There are several restrictions on the availability of these annuities. Since the redemption of warrants for annuities is the most conservative investment, it is envisioned that a significant portion of warrants would be used for annuities. No firm estimates are available from the Social Security Administration.

## 5. MANAGEMENT OF THE SCHEME

### 5.1 Role of the Organizations

The responsibilities of the WAU start as soon as warrants are issued. These responsibilities include the effective administration of the scheme and the WAU must be able to assess how well it is meeting its objectives and identify any corrective action necessary. This will require:

- a means of collecting and evaluating operational information from participating institutions;
- a mechanism for agreeing to and authorizing any action to be taken.

Although informal links between the WAU, the SPA and other institutions exist and should be encouraged, experience suggests that more formal lines of communication and authority need to be established to ensure the success of the system.

To illustrate this requirement we have developed the schematic diagram shown in Figure 5-1.

This diagram represents the institutions involved (in rectangular boxes), the organizations through which their activities will be coordinated (as triangles), and the assets to be delivered as compensation (as circles). The holders of the warrants, and the possibility of exchange of warrants via the secondary market, are shown on the extreme left of the diagram.

The diagram is augmented by connections between these entities, showing the flow of warrants and assets in compensation (arrows), the flow of information to coordinate the scheme (lines connecting the triangles on the right of the diagram), and the lines of legal authority (double lines) stemming downwards from the Government.

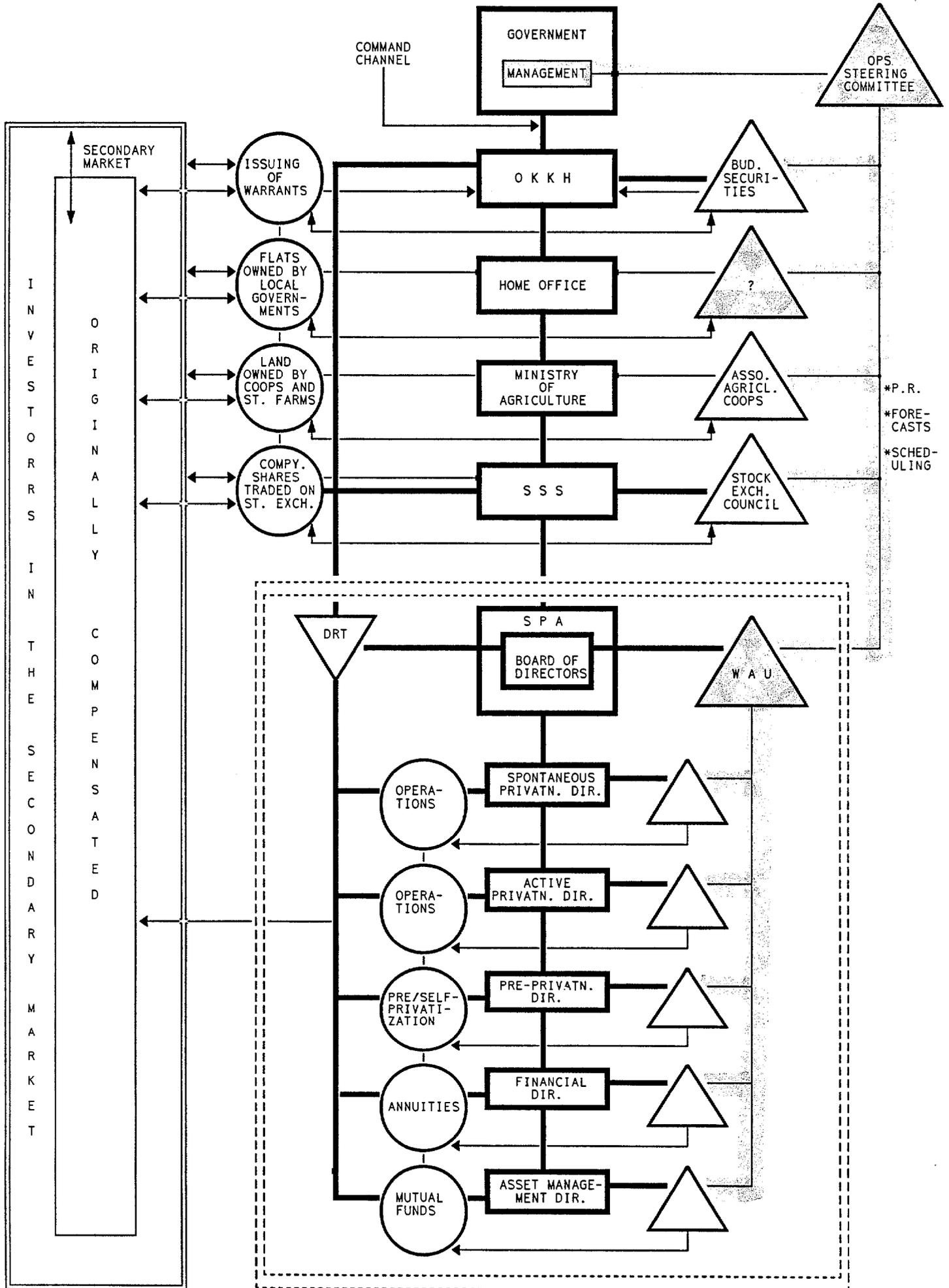
The role played by DRT (inverted triangle) during the study is shown by the contact (thick lines) made with organizations involved in the scheme.

The parts of the infrastructure that do not currently exist are highlighted in color:

- to manage the scheme we propose the establishment of an Operational Steering Committee (OSC) to coordinate operations and provide a forum to formalise the flow of information between the organizations in the scheme. NB: We note that Mr. Slosar has already taken steps to bring together representatives from each institution;
- the WAU, which needs to be made operational;
- there is currently no vehicle for coordinating Local Authorities, and we assume in the diagram that this will be the Home Office.

FIGURE 5-1

COMPENSATION WARRANT SCHEME



## 5.2 Processing Cycle

Figure 5-2 illustrates the processing cycle. Descriptions of the functions and the role and composition of the OSC are given below.

### 5.2.1 Planning

#### *Description*

The consolidation of planning schedules from all parties involved with the warrant scheme. These schedules will cover the issue of warrants and the provision of the various options for which they can be used.

This data will form the basis of an operational model of the warrant scheme. Once complete it will produce reports for interpretation by an analyst within the WAU and serve as the basis for recommendations to the OSC.

#### *Information Required*

Information will principally be required from:

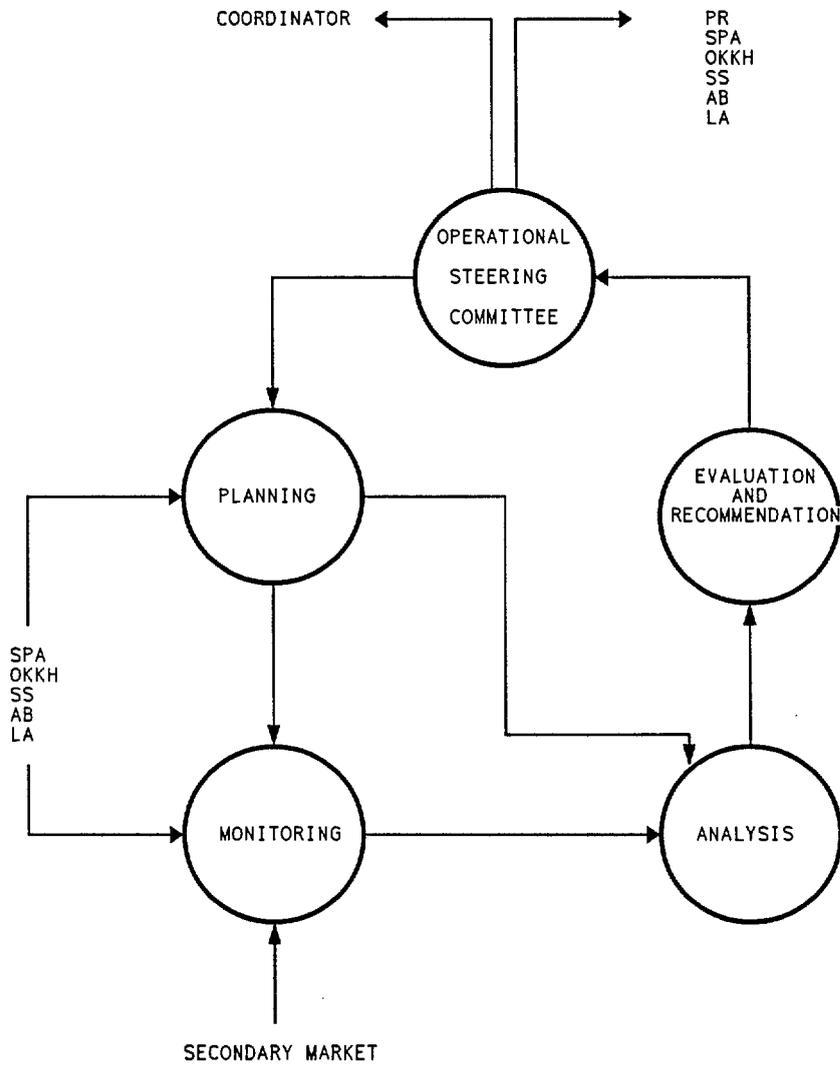
- OKKH, including detailed timetables for issuing decrees and warrants categorized by volume and levels of value. Information and the geographic location of the recipients is also required. OKKH also expect to collect indicative information on how warrants will be used by compensated persons, who will be asked to fill in a non-compulsory questionnaire when collecting their warrants;
- SPA. The SPA will need to make information available from its privatization plans, giving the percentage of shares available to the warrant system. These should cover the value and timing of companies being made available under:
  - . pre-privatization;
  - . self-privatization;
  - . active privatization;
  - . spontaneous privatization.

In addition, any plans for launching a mutual fund will need to be disclosed;

- Social Security Administration. It will need to supply information on the timing of this option becoming available and the projected take-up;
- Agricultural Board. It will need to supply the value and timing of land in each cooperative becoming available for purchase with warrants;
- Local Authorities. The value and timing of flats available for purchase using warrants in each locality will be required. An issue here is the lack of a coordinating body for the compilation of this information.

FIGURE 5-2

PROCESSING CYCLE



### 5.2.2 Monitoring

#### *Description*

The regular tracking and recording of operational statistics and variance against plans. This data will be fed into the operational model of the scheme.

#### *Information Required*

The information required for monitoring purposes is identical to that required for planning, except that:

- actual results will be required;
- latest updated forecasts are needed to identify trends as early as possible.

### 5.2.3 Analysis

#### *Description*

With the assistance of a computer model, capture and analyze the demand and supply streams as projected in the Planning process and recorded in the Monitoring process.

#### *Processing*

Construction of an Operational Model of the warrant scheme to cover:

- the schedule of warrants to be issued by value, volume and geographical area;
- projections of the various options available to warrant holders (as described in section 4.2 of this report);
- projections of the expected demand from warrant holders related to each option for using their warrants.

Updating the model with changes to plans and operational statistics to:

- compare actual demand and supply against plans, highlighting the major variances;
- analyze the actual pattern of usage by warrant holders and compare with the original projections, highlighting differences;
- re-forecast the value and pattern of future usage based on experience to date;
- illustrate, by means of graphics, the above information to facilitate further analysis and evaluation.

#### **5.2.4 Evaluation and Recommendation**

##### *Description*

Assess the success of the scheme in meeting its political, economic and operational objectives, making recommendations to the OSC of any actions required to keep the scheme on course.

##### *Processing*

Using the information supplied by the Operational Model, and any other appropriate sources:

- identify actual and potential problem areas;
- assess the need to take corrective action to react to problems and limit their effect;
- determine any action to be taken, where appropriate using the model to assist with "What If?" scenarios.

These three actions are to result in the formulation of recommendations for presentation and discussion by the OSC.

#### **5.2.5 Operational Steering Committee**

##### *Description*

The purpose of the OSC is to coordinate the operation of the warrant scheme.

The committee should be chaired by the overall coordinator of the warrant scheme (see section 6.1). Its members would be representatives of the institutions involved in the scheme:

- WAU (representing the SPA);
- OKKH;
- Social Security Administration;
- Agricultural Board;
- Local Authority Representative;
- State Securities Supervisor.

The chairman of the PR committee would also attend.

### *Functions*

The OSC will meet on a regular basis (e.g. every two weeks) to:

- review and approve the progress report issued by the WAU;
- discuss proposals and recommendations presented by its members and the WAU, and agree action to be taken.

Operational issues would be referred to the relevant committee member.

Issues that cannot be resolved in this Committee will be raised by the chairman with the appropriate authority e.g. Government Minister, institutional director.

The decisions of the OSC would be fed down to the WAU and the other bodies, for action to be taken.

## 6. ISSUES AND CONCERNS

This section highlights the main issues and concerns identified during the course of the study and which remain unresolved. A detailed list of the issues and their status is contained in Appendix III.

### 6.1 Coordination of the Scheme

The compensation scheme is a major undertaking involving a number of ministries and non-state institutions dealing with about 900,000 claimants and warrants to the value of over HUF50 billion.

The compensation law, together with further detailed legislation, sets out the duties and responsibilities of the various organizations involved in delivering compensation. However, it became clear early on in the study that no single authority had been made responsible for the success of the scheme, and no management framework had been established to ensure the activities of the organizations involved were coordinated.

We believe the success of the warrant program is at risk until the following issues are addressed:

- there is an immediate need to appoint an overall coordinator to assume ownership of this project, with the authority to drive the scheme with the active cooperation, at all levels, of all the parties involved. Such was our concern on this issue that shortly after the start of this study a letter was sent to Dr. Csepi, Managing Director of the SPA, highlighting the problem (see Appendix V). Following our letter a number of solutions have been discussed but no conclusion reached;
- while ad-hoc liaison on both policy and external matters related to the compensation scheme takes place between politicians and government officials at various levels, we propose an infrastructure, in particular the establishment of an Operational Steering Committee as described in Section 5, to improve the flow of data and degree of cooperation between the organizations associated with the warrant scheme, at an operational level.

### 6.2 Planning

Each of the organizations involved in the scheme has its own tasks and functions to perform within the legal framework. In practice this can only occur efficiently and effectively if:

- adequate planning and preparation is undertaken;
- the information upon which plans are based is accurate.

The ability of the WAU to be effective depends heavily on its ability to obtain accurate and timely planning and operational data. The planning information currently available is clearly inadequate, for example none is available from OKKH, the issuer of warrants, and very little detailed information exists within the SPA on the investment opportunities for warrant holders. The development of comprehensive plans by these institutions must be given the highest priority.

### 6.3 Importance of PR and Training

#### *Public Relations*

The results of a recent survey highlighted the need for significant efforts to inform and educate the public. In addition, the negative publicity following the pilot issue of warrants last December emphasized the need for an effective PR campaign. A first step was a PR meeting organized by the study team in December which gained commitment among the organizations to improving the quality and flow of public information. It was agreed that this information should be coordinated through a central body. For the time being, the SPA's PR organization has assumed responsibility for this coordination.

The importance of managing public and warrant holders expectations is essential to the credibility of the scheme and the effectiveness of the WAU in fulfilling its commitments. Our proposals in section 8 and detailed in Appendix V, illustrate how this can be achieved with the help of an effective PR campaign.

#### *Training*

We found a limited staff awareness of the scheme. There was generally a good understanding of the scheme among the senior managers interviewed during the study, however, at junior management and operational levels we found considerable misunderstanding.

It is vital that the staff at the SPA have sufficient training to enable the WAU to carry out its role efficiently.

We feel that the credibility of the scheme depends equally on the degree of competence shown by staff in the other institutions involved with warrants.

These issues are addressed in section 8.

### 6.4 Current WAU Staffing

The WAU currently consists of only one person within the SPA. Our work shows that the WAU's role is chiefly one of formulating policy, making recommendations, liaison, information collection, planning and information dissemination (as opposed to a large clerical operation), and that additional manpower resources are required.

Proposals for the organization and staffing of the WAU are in Section 7, and subject to their approval, recruitment should start as soon as possible.

## **6.5 Legal Issues**

We have proposed an organizational structure which we believe is crucial to the operation of the warrant scheme. There is no provision in the current legislation which empowers a scheme coordinator or an OSC, however, this may be handled separately by the Government.

## **6.6 Fraud**

One of the issues identified during the study was the potential loopholes for fraud within the proposed scheme and highlight areas where special measures would be needed. Examples are the re-use of warrants, forgeries and corruption. However, the absence of firm operational plans by the other organizations involved has meant that it has not been possible to progress this.

Responsibility for this issue has to be decided, but the exercise should be carried out before the main scheme goes live.

## **6.7 Limited Budget**

Funding required for the warrant scheme in total is outside the scope of this study. However, it is apparent that financing for the public relations campaign must be sought. Due to the Hungarian budget limitations, we can expect that the source for this must come from outside. Once a PR Action Plan is adopted, cost options should be examined and a funding request put forward. Other financing requirements may be quantified by the coordinator of the scheme upon his appointment.

The SPA has a Forint budget, approved by Government, to cover the expense of hiring the personnel needed to discharge its responsibilities. This budget is necessarily restrictive, given the current state of economic development in Hungary. It is for these reasons that we have been asked directly by the SPA to consider how activities required in respect of warrant administration might obtain additional funding, particularly to meet foreign currency costs for advisors and equipment, addressed in section 10 and Appendix VI.

## **7. WARRANT ADMINISTRATION UNIT**

### **7.1 Role and Responsibilities**

The role of the Warrant Administration Unit (WAU) is to ensure an effective and smooth process for redeeming warrants for shares in privatizing entities. Consequently, its responsibility is to cooperate with, and coordinate and monitor the activities of, all institutions involved in the compensation scheme in support of the scheme's defined objectives. This includes selecting the assets from the SPA within the privatization program to meet the availability of warrants. Since the WAU will have access to the most comprehensive information on the progress of the scheme, its role can be expected to include support to the OSC.

It is anticipated that the WAU will consist of a small number of staff reporting to the unit head. As shown in the organization chart, Figure 7-1, there are two primary functional areas within the WAU, Operations and Policy Analysis, with an overall manager.

### **7.2 Management of the Warrant Administration Unit**

It is expected that the head of the WAU will delegate supervision of operational functions as he focuses on issues related to warrant scheme policy, relationships between implementing institutions, publicity, and reporting to SPA management and other committees.

For example, it is expected that the head of the Warrant Administration Unit will serve as one of the SPA's two representatives to the inter-agency Task Force on Public Relations. The other representative should be the SPA's Director of External Affairs, who is responsible for their public relations.

The head will also report to the compensation scheme Operational Steering Committee and make recommendations for action, outlining the impact of demand and asset supply on the equity market and on warrant value.

In addition to maintaining external relationships, the WAU head will be responsible for integrating the unit with the SPA's asset management operation as a whole. Moreover, he will coordinate and monitor the activities of other departments within the SPA in support of the objectives of the compensation scheme.

In the first six months of operation, it is recommended that the head of the WAU have an advisor to provide support in the planning, policy and operational functions. This should provide the WAU with a greater range of experience in management skills and access to the specialist knowledge that will be required when performing his duties. The terms of reference for an advisor should be developed during the setting up of the WAU.

# WARRANT ADMINISTRATION UNIT

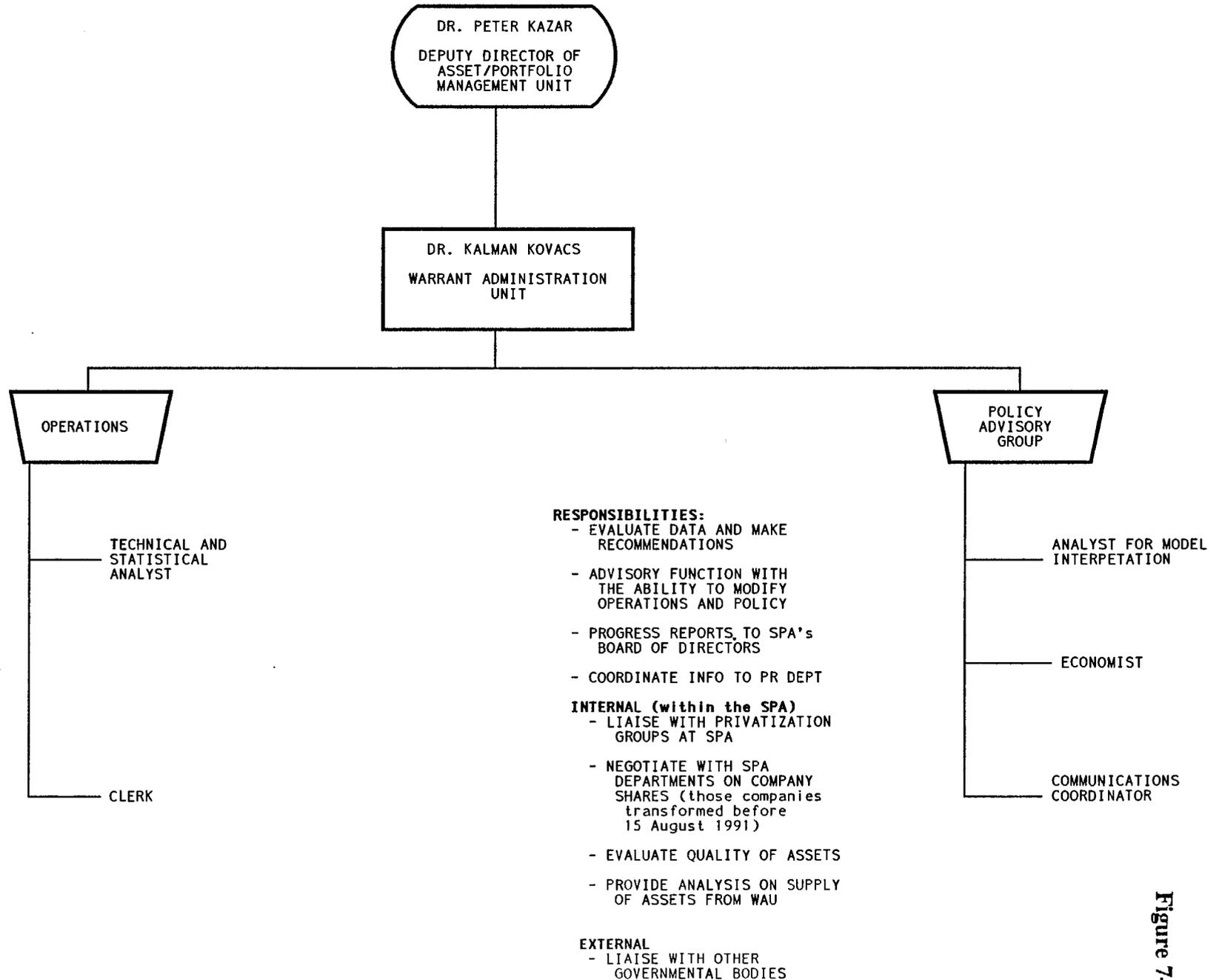


Figure 7-1

### **7.3 Operations Group**

The primary responsibility of the Operations Group is to meet the legal and documentary needs of the WAU. It will need to collect data from the OKKH, the Ministry of Agriculture, the Stock Exchange, municipalities and from other SPA departments. The purpose of collection of this data is support the planning and monitoring functions of the WAU. As a result, it is imperative that the Operations Group ensure the timeliness and accuracy of the data which is submitted.

It will also be necessary for the WAU's Operations Group to supply information to the accounting department of the SPA for internal records and returns to the Ministry of Finance.

A staff of two people for this group is proposed, a clerk and a technical/statistical analyst.

#### *Clerk*

The clerk will gather data received from various implementing institutions, ensure that the data is submitted on time, and monitor accuracy of data received. On a regular basis as instructed by the head of the WAU, the clerk will enter the data into the operational model and print reports for the Policy Analysis Group.

The skills required by the clerk include a familiarity with using computers, a basic understanding of accounting and/or statistics, strong attention to detail, and aptitude for training in data base use, including data input and report generation.

The WAU may need to hire an additional clerk in the future, as the unit grows and greater data collection and entry demands are placed upon the Operations Group.

#### *Technical and Statistical Analyst*

The technical specialist will maintain the hardware and software of the WAU, as well as the operational model. This will include responsibility for revising the programming of the model, after it has been developed by the consultant team, to meet the evolving needs of the WAU.

The analyst will also be responsible for maintaining the links between the SPA's Information Management Department and the WAU. This includes integrating WAU systems with the SPA's Privatization Information System, and transferring WAU accounting information to SPA's accounting system.

The analyst must have an automated systems background, including knowledge of using Novell-based local area networks, limited programming experience using application software such as Excel or statistical packages, and knowledge of statistics.

### **7.4 Policy Analysis Group**

The primary responsibilities of the Policy Analysis Group will be to evaluate data about company assets and warrants issued and recommend policy which ensures those are in balance. It will be important that this advisory group understand the quality of the assets which are available to warrant holders, are aware of the acceptability of the assets by the brokers, and provide sufficient information to the OSC to communicate the asset value to the public.

The group will support the head of the WAU through providing him with analysis and recommendations to pass on to the Operational Steering Committee. They will provide support in selecting companies from the SPA's privatization case officers for quality assets for the warrant scheme. They will also assist the head of the WAU in liaison with institutions external to the SPA, such as the Agricultural Board and Local Authorities, to learn their investment plans and intentions. A key element of this support will be preparation of reports and presentation of statistics for internal and external review.

The Policy Analysis Group will initially involve external advisors with skills to cover Investment Analysis/Economics including familiarity with the Hungarian equity market, Communications Coordination to assist in communications with both the implementing institutions and the public, and an analysis effort responsible for interpretation of the Operational Model.

#### *Investment Analyst/Economist*

The primary role of this advisor will be to evaluate, independently, the company assets which are available to the warrant scheme and advise the head of the WAU about the "marketability" of those assets. They must have or develop a relationship with the Hungarian broker community in order to learn the markets perceptions of the companies to be privatised. Also, they should have the ability to draw upon sector specialists, within the SPA and appropriate ministries, to provide a review of the quality of company shares.

The Investment Analyst/Economist will work with other members of the Policy Analysis Group to provide a business perspective to the WAU. They will liaise with other departments of the SPA to gather comparative data on the quality of the assets.

The qualifications of the Economist must include a practical experience of well-developed capital markets in addition to familiarity with the Hungarian market. In addition they should be able to interpret company financial, marketing, and production data to evaluate the quality of assets.

#### *Communications Coordinator*

The Communication Coordinator will assist in presentation of data and recommended actions which would maintain the public confidence in exchange of warrants for shares. He would support the Public Relations Task Force to assist them to communicate the progress of the scheme, the investment opportunities available, and legal requirements of the scheme.

The Coordinator should have a familiarity with both statistics and economics in order that they might understand the statistical information produced by colleagues in the WAU. They should also have prior public relations experience, particularly in working with outside public relations firms.

### *Analyst*

Interpretation of reports from the model generated by the Operations Group will be the principal responsibility of the analyst. Based upon the statistical output of the model, he will determine the supply of warrants and demand for assets and identify any shortfalls. The analyst will work closely with other members of the Policy Analysis Group and the head of the WAU to determine action steps to maintain the balance of warrants and assets.

The background of the analyst should include comprehension of statistics, familiarity with automated statistical models, and experience in developing and presenting statistical analysis.

## **7.5 Technical Assistance**

At the same time as identifying and recruiting staff for the Operations Group, some urgent set-up tasks will be undertaken by consultants. Proposed technical assistance in the set up of the Operations Group will include:

- the definition of operational support and the compilation of operational procedures for data collection;
- definition and production of the initial Operational Model;
- approval job descriptions, recruitment and training;
- determination of accounting and statistical information required by other SPA departments from the WAU and vice versa;
- establishment of automation links with the SPA's information systems and other databases.

Technical assistance in the establishment of the Policy Analysis Group will focus on the data analysis and the communications function. The technical assistance tasks will include:

- identification of advisors;
- report and presentation formatting;
- communications/public relations work planning.

Ongoing policy support will also need to be provided to the head of the warrant administration unit during the establishment of the WAU.

Terms of reference for these and other tasks for initial support for the establishment of the WAU are listed in Appendix VI.

## 8. COMMUNICATION NEEDS

The communications needs of the compensation scheme fall into two main areas:

- public relations, defined here as the education of warrant holders, and all those involved with or affected by the warrant scheme. As this will comprise an extremely wide audience, PR techniques to make effective use of the media will be particularly important;
- training, covering the needs of staff within the organizations responsible for delivery of the scheme.

These PR and training needs are described below.

### 8.1 Public Relations

During the course of this consultancy assignment, the study team developed a detailed Public Relations plan, which is shown in Appendix IV to this report.

The plan proposes the establishment of an inter-agency Task Force with responsibilities for delivering:

- a clear and concise booklet to be distributed to warrant holders, and posters as necessary;
- an Information Center to provide answers to warrant holder's queries;
- a seminar for the financial community;
- the release of information through television, radio and other media contacts.

### 8.2 Training

We have identified that training is necessary for the implementation of a credible, effective, compensation scheme. There are a variety of training needs across all the organizations involved including: the SPA generally and the WAU in particular, Municipalities, Social Security Administration, Ministry of Finance, Agricultural Board, Banks, OKKH and Budapest Securities.

Notwithstanding the fact that these organizations have their own training capability, each organization should understand its legal obligations, reporting requirements to other institutions and its responsibilities to provide correct information and guidance to warrant holders.

The training needs of these organizations can be identified at two levels:

- general awareness of the scheme, their organization's role and the relationships between the other organizations involved;
- specific operational training for the tasks individuals have to perform.

Given the current lack of authoritative information about the details of the scheme, most if not all the organizations would benefit considerably from training at the first level. In some instances, training support at the second level is desirable.

### **8.2.1 SPA/WAU Training Needs**

Selected staff at the SPA and all new staff in the WAU require general awareness training.

The WAU requires particular skills and in-depth knowledge, and it is envisioned that careful recruitment of staff will provide a basic level of ability. It is likely that this will need to be enhanced through skills transfer from external specialists and/or attendance at appropriate courses. A task to define specific skills-related training needs of the WAU are identified in Appendix VI.

In both the short and long term the WAU is likely to require the resources to organize "training workshops", possibly jointly with other institutions where a common need or problem exists. These workshops would provide a forum in which to develop solutions to such problems, perhaps at times with the help of an outside specialist.

The WAU will need to work with the SPA Training Officer when addressing its training needs, identifying the individuals currently in post who should receive training and the type and level of material necessary to achieve the training objective.

### **8.2.2 External Training Needs for Implementation**

We have identified urgent training needs outside the SPA to address the problem of a lack of awareness and understanding among junior management, which may be partially addressed through a general awareness training program.

We understand that the responsibility for providing training is primarily that of the organization concerned. However, there should be supervision of the training effort to ensure that training needs are being met, and this should rest with the OSC since the provision of training affects the effectiveness and credibility of the scheme.

If the plan to implement an Information Center is progressed, the staff and management of that unit will also require training as a matter of urgency. This training task could also be undertaken by the same team, with the addition of customer skills training.

### **8.2.3 Summary of Training Needs**

We believe that the scheme would benefit considerably from both general awareness and specific training programs. Since the first impressions of the public as to how well the scheme is being managed will be key to the credibility of the scheme, the immediate need could be met through a "train the trainers" approach to promote general awareness among the organizations involved.

In the case of the SPA and WAU, the specific training needs identified could be covered in an efficient and timely manner using:

- on-the-job skills transfer from external specialists;
- attendance at appropriate formal courses, seminars and workshops;
- internal training workshops.

## 9. CONCLUSIONS

By mid-March, the time when a substantial number of warrants are due to be issued, the following need to have been accomplished:

- the appointment of a Scheme Coordinator and establishment of an Operational Steering Committee (OSC);
- the initial public relations effort;
- an operational WAU.

### 9.1 Realize Overall Coordination

#### *Appointing a Warrant Scheme Coordinator*

The requirement is for a person with diplomatic and political skills with a strong desire to see the scheme through to a successful conclusion. Candidates could include members of the Economic Council or Members of Parliament.

#### *Establishing an Operational Steering Committee*

The Operational Steering Committee, as the vehicle through which the Warrant Scheme Coordinator, as chairman, will mainly operate. The OSC will provide a forum to formalize the flow of information between the various organizations in the scheme and coordinate planning and action, and should be supported by the WAU as owners of the operational model of the scheme.

### 9.2 Implement Initial Public Relations Tasks

Before the warrants are issued, it is imperative that a general publicity campaign is conducted. Accordingly, some immediate support for the design and printing of the information booklet, posters and other appropriate PR materials is suggested in the terms of reference in Appendix VI.

A more detailed PR action plan, including projected costs, should be adopted using the suggestions in Appendix IV and recommendations of committee members. Terms of reference should be developed and a tender issued for long term support of public relations firms to execute the PR campaign.

### **9.3 Make the WAU Operational**

The SPA should agree the organizational structure for the WAU, as defined in section 7. Once agreed, recruitment of additional staff must begin for the WAU to meet the demands of the scheme when it becomes operational.

In addition to recruitment, terms of reference for important set up tasks are included in Appendix VI.

### **9.4 Funding**

External financing to meet the foreign currency cost of the overall compensation scheme is expected to be required for the implementation of the Public Relations Campaign. SPA budget resources will be used to meet local currency costs for salaries and office space . The cost of advisory services and equipment to set up and operate the WAU will require external funding. Terms of reference for the initial tasks have been included in Appendix VI.

INSTITUTION	CONTACT
AVU - STATE PROPERTY AGENCY	Dr. Lajos Csepi Charles Twyman Barta Károly Dr. Bokodi Béla Dr. Bóth János Dr. Gelenyi Csaba Dr. Havasi Márta Dr. Kazár Péter Dr. Kovács Kálmán Dr. Slosár Gábor Dr. Vámos Ferenc Holló George Fejesné Pécsi Éva Virág László
BUDAPEST BANK	Tóth Judit
BUDAPEST CITY MUNICIPALITY	Dr. Glausius Judit Györi Péter
BUDAPEST STOCK EXCHANGE - TOZSDE	Dr. Hardy Ilona Faragó Éva Reményi Zoltán Rotyis József Schalkhammer Erika
BUDAPEST STOCK EXCHANGE CONCIL	Huszár András Lantos Csaba
BUDAPEST ERTEKPAPIR Rt. Zsuzsa	Dr. Jasper Miklós Galbicsekné Molnár
CITIBANK	Igaz Katalin
CREDITANSTALT	Csaba Lantos
GENERAL BROKER	Dr. Hoffmann László Dr. Markó Judit
HUNGARY-AMERICAN ENTERPRISE FUND	Dr. Huebner Charles
INTER EUROPA BANK	Fazekas Andrew
INTERFACE Kft.	Bokor Istvánné Petróczi Károly
KARPOTASI TORVENY JOGASZA	Dr. Szabady Attila
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OTP BANK	Dr. Bodnár Jánosné Matuk Károly
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PRI-MAN Kft.	Tánczos Gábor
PRIME MINISTER'S OFFICE	William M. Dewey
SSA OTF	Dr. Barát Gábor Dr. Benna György Dr. Vidik Gyöngyi
SSS ERTEKPAPIRFELUGYELET	Dr. Pacsi Zoltán Dr. Molnár István
XX. DISTRICT	Dr. Perlaki Jenő Dr. Bósze Lajos

## COMPENSATION SCHEME - DESCRIPTION

In this Appendix of our report we give an outline description of the proposed compensation scheme, consisting of:

- an overview of its intended operation showing the primary flows of warrants and assets involved;
- the procedures for beneficiaries under the scheme;
- the current understanding of how compensation will be delivered through the ten options available.

### *Overview*

The diagram shown in Figure 4-1, which is in section 4 of the main body of this report, illustrates the scheme showing:

- the institutions involved in the scheme;
- the flow of warrants:
  - out from the scheme via OKKH and Budapest Securities, shown by downward arrows on the left hand side of the diagram;
  - back to the SPA, shown by the upward arrows towards the right hand side of the diagram which are associated with one of the ten options for using the warrants. For completeness, we have included in the diagram a representation of the flows resulting from the expected secondary market in warrants as option IX, and the proposals for participation in a Mutual Fund(s) as option VIII;
- the flow of assets from the scheme, shown by the downward arrows towards the right hand side of the diagram.

In options II through to VI, the assets given in compensation are not directly owned by the SPA. In these options, the warrants will not be immediately extinguished but the bank, cooperative etc. concerned will become the bearer. The warrants are thus only truly extinguished when used via option I, VII, IX or X.

## 1. CLAIM PROCEDURE

### 1.1 Resolution of the Claim

The OKKH organization is responsible for the resolution of claims for compensation. OKKH has been set up specifically for this purpose and is funded and managed separately from the SPA.

County Compensation Offices will send a resolution on compensation to each beneficiary. The resolution comes into force after fifteen days, unless the beneficiary makes an appeal within that period.

## 1.2 Obtaining the Warrants

The beneficiary will be able to obtain his compensation warrants after twenty-five days from the date of the resolution. The warrants may be collected from the brokerages indicated on production of the resolution and proof of identity. Brokerages have been appointed via the contract between OKKH and Budapest Securities.

If the beneficiary is unable to personally collect his/her compensation warrants in person, a third party can be nominated using an authorization form sent with the resolution. The beneficiary's signature on this form must be witnessed by a public notary for it to be acceptable to a brokerage. The third party must then present this documentation with proof of his/her identity.

The person collecting warrants will be required to sign a receipt confirming that fact. At the same time:

- it is intended that the brokerage will make available more information as to ways that warrants can be used;
- he/she will be requested to complete a statistical sheet stating what use he/she expects to put the compensation warrants to. It will not be mandatory to complete this statistical sheet, which will not contain the identity of the claimant.

## 1.3 Using the Warrants

The compensation warrants received can be taken away or can be deposited. If the decision to deposit is made, the depositary service is free of charge. The beneficiary will be issued with a certificate of deposit.

As the warrants are bearer documents, use of this depositary facility eliminates the risk of loss of the securities. For example, if a beneficiary wishes to purchase land where the auction will not be held for six months, he can deposit his warrants at the brokerage until the date of the auction.

This certificate can be used as an equivalent to the compensation warrant for utilization according to clause II.b./2 in the law.

Under the depositary scheme, the brokerage must be able to provide information as to the eligibility of the certificate owner including whether the owner is the original bearer.

## 2. COMPENSATION FOR FOREIGN CITIZENS

Compensation warrants can be taken out of and brought into the country without the permission of the foreign exchange authorities.

### *Direct Beneficiaries*

For a compensated non-resident to acquire property with compensation warrants, it will

not be necessary to obtain the permission of the foreign exchange authorities or a preliminary licence of the Ministry of Finance according to Act I of 1987 on land.

#### ***Warrants Purchased on Secondary Market***

Where the bearer of the warrant is a non-resident but is not the compensated person, they can acquire state assets, shares or business shares only with the prior permission of the foreign exchange authorities.

### **3. USE OF THE COMPENSATION WARRANTS**

It is intended to provide the following opportunities to those possessing compensation warrants.

#### ***I. Pension Plan***

The owner of warrants can purchase an annuity provided they:

- are the original bearer of the warrants;
- can meet the conditions set forth in the relevant Act.

The annuity will be calculated in accordance with the sex and age of the applicant, and will be disbursed by Social Security Administration.

#### ***II. Land Ownership***

Compensation warrants can be used to acquire arable land as described below.

##### **Conditions**

Those persons purchasing land under the compensation scheme must:

- put it to agricultural use;
- not withdraw it from agricultural production for five years.

Qualified persons, defined under Par.21. of Act XXV of 1991, who:

- undertake to register with the tax authorities as an agricultural entrepreneur within 30 days of the relevant auction;
- has indicated his intention upon submitting his claim for compensation;

may apply for subsidy for agricultural enterprise amounting to the difference between :

- the amount of the damage suffered calculated according to Para.3. of the Act;
- the amount of compensation calculated according to Par.4. of the Act (warrants).

The combined amount of the compensation and of the subsidy cannot exceed HUF1 million.

### **Auctions**

The designated land will be sold to those entitled to compensation by way of auctions. The earliest and latest dates of auctions will be determined by the County (Budapest) Compensation Office according to the seat of the cooperative taking into consideration the assessment of the claims for compensation. The Office must publish the date of the auction at least 30 days in advance in the Magyar Kozlony (the official Hungarian bulletin), in at least one national and in one county daily. Auctions will also be announced locally.

Persons entitled to compensation can take part in the auction of cooperative land with their compensation warrants where:

- their expropriated land is owned or used by the cooperative;
- they were a member of the cooperative on January 1, 1991;
- whose permanent residence on June 1, 1991 was in the village or town in which the land of the auctioning cooperative is located.

In the case of land owned by the State which is being auctioned, the beneficiary of compensation needs to prove only his entitlement to compensation.

### **Rights and Conditions**

The onus of proof of eligibility lies upon the person taking part in the auction.

It will not be possible to change the results of an auction, absence from an auction causing a loss of rights. However, an authorized representative of the person entitled to compensation may act in his name at the auction.

Persons meeting the above conditions who wish to take part in an auction must deposit their compensation (warrants plus subsidy). An auction advance of 20 per cent of the value of the deposit shall be due to the State.

A farmstead owner bidding for the land around his farmstead has the right to pre-empt the auction price (defined as the last bid) if his bid is covered by his compensation warrants plus subsidy.

### **III. Banks (Use of Compensation Warrant for "E" Loans, etc.)**

In case of loan applications under the legal regulation on Existence Loan, or in the case of applications for privatization loans, the bank receiving the loan application shall consider the compensation warrant, at nominal value, as the funding mandatory put up by the applicant on the basis of Government Decree No. 27/1991.(II.21.).

#### **IV. Flats purchased from Local Government**

Persons who are the original bearers of compensation warrants can use them as legal tender at nominal value for the purchase of:

- tenement flats owned by the State;
- tenement flats transferred to the ownership of local government from the ownership of the state after the promulgation of the Compensation Law.

#### **V. Ownership of Companies in Pre-Privatization Process**

Compensation warrants may be used at auctions aimed at the sale of the ownership right or right of lease of retail or catering outlets, consumer service units sold according to Act LXXIV of 1990.

Compensation warrants can be used at nominal value in conjunction with cash and the Existence Loan. They may form up 50% of the auction price. The person obtaining the premises shall bear the privatization costs in cash.

#### **VI. Share or Partial Ownership of Companies in Self-Privatization**

At the brokerages who will issue the compensation warrants, beneficiaries may choose from:

- a list of the currently offered shares, business shares offered in the current phase;
- a list of the privatization consultants administering the self-privatization process.

#### **VII. Shares in a Company**

These may be acquired by any bearer of a warrant, not necessarily the original owner.

Similar to option VI, lists of the business shares in Rts and Kfts will be available at the brokers.

The intention to use compensation warrants in part or full payment for the shares must be made at the time of application. After the closing date for offers the applicant will be notified as to whether a successful application has been accepted in full or part. Cash and warrants not accepted will be returned to the applicant.

#### **VIII. Mutual Funds**

It is emphasized that this option is at an early stage of development, following the recent ratification in law of the position regarding mutual funds.

Under such a scheme, the warrant holder would be entitled purchase a share/unit of the mutual fund(s) set up for that purpose.

#### **IX. Cash from Secondary Market**

The bearer of a warrant may choose to sell it for cash value, determined by market forces, in a secondary market. The Stock Exchange will create a secondary market under the jurisdiction of the Securities Act.

## **X. Shares in Kft.**

Warrants may be used to acquire shares in limited liability companies.

To do this the purchaser would present his warrants to a broker. To qualify under this scheme, the bearer must have compensation warrants worth HUF100,000 as the required prime deposit.

After 30 days, unless the State Property Agency has not obtained the waivers of pre-emption rights from the members of the limited liability company, the applicant becomes the owner. To complete the transaction the applicant must report at a given address:

- presenting his warrants/deposit certificate;
- showing proof of identity.

The transfer of ownership is completed by:

- signature of the forms to notifying the company of its new owner;
- enacting the transfer of ownership of the company in front of a notary and with two witnesses;
- acknowledging the provisions of the Articles of Association as legally binding.

## KEY ISSUES RAISED AND STATUS

This Appendix lists the key issues identified and addressed by the Warrant Administration Unit Needs Analysis team. The issues, and the findings of the study team which progress them, are structured under three main headings:

1. Actions to support Political Objectives
2. Actions to support Economic Objectives
3. Operational Actions

## 1. Actions to support Political Objectives

### *Issue 1 The capacity and capability of the broker network*

A "broker network" is being set up by Budapest Securities in consortium with OTP. Their contract has been let by OKKH. The role and scope of the broker outlets is:

- to receive notification of decrees (approval of claim for compensation) issued by OKKH;
- to issue warrants to the claimants (or their representative) on production of the decree. A safe deposit service will also be offered.

Budapest Securities are confident that they have made adequate arrangements for the distribution of warrants, but are concerned that their issue should be planned and controlled. A first tranche, originally planned for 15 January 1992, was not seen as a problem. Investigation of the systems that will be used was carried out to determine the adequacy of the proposed systems. It was not possible to quantify exactly their state of readiness as operational trials had not been conducted.

A meeting with Jasper Miklos (head of Budapest Securities) was conducted on 19 December to clarify in further detail:

- the capacity of the broker network set up. In this respect, the directors of Budapest Bank in the counties were concerned about an uncontrolled flow of decrees creating uneven demand for services to supply warrants at branch offices. Budapest Securities wish to avoid lengthy queues.

It is believed that this problem has been addressed by introducing coordination between the county directors and their equivalents on the local indemnification boards;

- The distribution of warrants will be coordinated in the following way, governed by a 25 day cycle:
  - the OKKH local office will inform/agree the decrees to be posted on a weekly basis with the local Budapest Securities representative as above. Following posting of the decrees on the following Tuesday, 3 days will be allowed for delivery after which the claimant has 15 days in which to lodge any appeal against the compensation awarded;
  - the OKKH center office is then advised of these details by the local OKKH office, 3 days being allowed for postage of these details;
  - the OKKH center office consolidates the local details and passes a floppy disk to Budapest Securities;
  - within 3 days the Budapest Securities central office will make up envelopes containing warrants in appropriate denomination for the size of the claim, insert the agreed information documents and address the envelope with the details given on the floppy disk;
  - the envelopes with warrants will be distributed in vans with appropriate security measures.

- the role of branch staff in Budapest Bank and OTP. This is to include the distribution of information leaflets produced by the SPA on how warrants can be used, giving guidance (rather than professional advice). The State Securities Supervisor (SSS) has concerns about the quality of this advice and whether warrant holders might be directed towards the options that generate revenue for Budapest Bank. Jasper Miklos did not elaborate (due to time pressure in the meeting) on any special instruction or training being given to branch staff.
- plans are being made to make four types of information available at the branches, relating to the different uses that might be made of warrants as follows:
  - the local OKKH office had contacted local agricultural boards, who are to supply details of the land for sale and auction dates etc. Such notices will be passed on to the Budapest Bank director for the area and the notices would be displayed in appropriate branches;
  - the local Budapest Bank directors were making contact with the mayors of the areas they were concerned with, and expected to be supplied with details of flat/property sales to take place;
  - the local Social Security Administration representatives were expected to supply information sheets and application forms for annuities to the local Budapest Bank director;
  - centrally, the Budapest Bank is coordinating with the SPA to obtain a list of the public offerings for sale and the prospectuses.
- the handling of privatization issues. This is also discussed under Issue 7, which is concerned with the availability of SPA wholly or partly owned assets.

NB. On 30 January 1992 OKKH revised their estimates of the number of claims to 900,000, it is not clear how the broker network will be able to handle this volume.

## *Issue 2      The co-ordination of Public Relations*

During almost all of the external interviews conducted, the general lack of information about the compensation scheme and the associated privatization program was a common complaint.

It was also apparent that corporate communications within the SPA were poor.

A separate report (enclosed) describes the detailed issues and recommends a PR campaign. It also contains the results of an opinion survey conducted in September 1991.

The first action is to organise an inter-agency "Public Relations Task Force", and this was agreed at a meeting on 17 December of representatives of all involved in the primary issue of the warrants (OKKH, SPA, Budapest Securities, DRT and PR advisors).

A trial issue of warrants was held on 27 December for 350 claimants. This was processed manually.

## 2. Actions to support Economic Objectives

### *Issue 3 The investment policy of Institutions*

A series of interviews with representatives of sample institutions, covering Local Authorities, cooperatives etc. are planned to be completed in January.

From interviews held so far, two bank representatives issued were concerned about their obligations to receive warrants. They are also concerned that it is not clear under which circumstances the SPA accepts the warrants at nominal value, and at market value.

### *Issue 4 The capacity of the Budapest Stock Exchange*

A meeting was held between the Budapest Stock Exchange (BSE), the SPA, the study team, and Budapest Securities.

Discussion was based on the then current estimates for the number of claims of around 500,000 with a possible value of between HUF40 and 50 billion. A significant number (around 30 per cent) of those claims were for small amounts i.e. up to HUF24,000.

It seems probable the holders of lower amounts of warrants will look for the quickest way to realize their compensation in cash, i.e. via the secondary market. However, the effect on the secondary market is expected to be minimized because the issue of warrants is to be staggered.

The SSS are of the opinion that trading capacity in the secondary market will not be a problem, since the OTC market will operate as well as the BSE. However, if banks bulk up retail orders to conduct one large trade in the market, separate trading rules might be needed.

Settlement has not really been addressed, but is not expected to be the major concern because of the staggering of issues mentioned above. It is seen as impractical to immobilize the warrants because of the short timespan of the scheme and the lack of a recognized depository that is operational.

The main concerns are:

- the provision for suspensions within the law could mean that different series of warrants may be ineligible for participation in a privatization issue. If this occurs it will be damaging to the liquidity of the secondary market, with a negative effect on price. A legal opinion needs to be sought and a policy statement issued by the SPA;

- while the first four companies to be privatized have been selected by the SPA, the schedule of SPA companies to be made available to warrants via public issue over the entire life of the scheme is not known. Indeed, even the readiness of three of the initial four companies has been challenged by the SSS. In the absence of this information and the timing of such issues it is not possible to fully assess the impact of the privatization scheme.

As a general conclusion, the concerns of the secondary market institutions are a lack of information. This affects the ability of the secondary market to provide the necessary facilities and capacity for trading and settlement.

From brokers/banks with commercial clients, concern has been expressed that prudent advice cannot be given to clients (both as prospective buyers or sellers) without more details about the scheme. This is not just planning information, but also the legal interpretation on important points of detail, including the effect of currency law on foreign buyers or warrants, the tax treatment of warrants.

#### *Issue 5      The consequences of heavy secondary market sales*

The grey (unofficial) market in warrants has them trading at 20% of face value. The SSS suggest that an official (regulated) market must exist as soon as possible to establish a fair market price. The main concern of the SSS is that inexperienced investors will be cheated, thus compensated persons should be told about the (official) secondary market when they receive their decree/warrants.

The BSE have so far assumed that their market will not be required to trade warrants until around May.

Clearly, it is in the interests of the scheme to have a high secondary market price as this increases credibility for otherwise:

- a dramatic discount against the nominal value of the warrants when dealing for cash will cause compensated persons to feel that they have not received their entitlement;
- market sentiment giving a low value to compensation warrants may be seen as a reflection on the value (or valuation) attributed to state assets. The net effect would be to suggest to compensated persons that they are not receiving an adequate level of compensation.

#### *Issue 6      How to counter or prevent heavy price falls*

Measures are available at a number of different levels:

- providing high quality assets in exchange for warrants. Although attempts to achieve this are being undertaken, this will not improve the secondary market price unless people know in advance what they will be able to use warrants for. So, full and public information on the good value that will be available (i.e. specific assets in the program) will:
  - increase the number of buyers of warrants in the secondary market, since they will see the assets they wish to purchase on the list of assets available;

reduce the number of sellers of warrants for cash, since the benefits of redeeming them will become apparent.

Erika Schalkhammer of the BSE (who runs the trading operation) is of the opinion that the money supply in Hungary is too small for such a large issue and there will not be enough buyers, therefore she suggests that foreign money (buyers) are needed. The Ministry of Finance (Gabor Kamaras) observe that there is a technical infringement of currency law in foreigners purchasing warrants and subsequently using them to participate in privatizations, although direct cash participation by foreigners in privatization is allowed.

The SPA believe that the accrued interest on warrants is not liable for tax. If so, this might make holding them an attractive proposition for high rate taxpayers.

- intervention in the secondary market. The SPA are prevented by law from doing this. The Ministry of Finance do not wish to do it, and in any event do not manage government debt issues centrally so the apparatus for dealing in the secondary market is missing.

Budapest Securities have made a proposal to the SPA to operate a stabilization fund. The cash for the fund would come from the proceeds of privatizations. They have also made a proposal to Dr Csepi to operate a scheme which would demand that (foreign) investors must use a minimum % in warrants. These proposals have not been taken up.

The main objection to intervention is political. If the government were seen to be purchasing compensation debt at lower than nominal value credibility may suffer as this may be seen as "cheating" on the part of the government. However, intervention might be considered if the secondary market price is so bad that any negative effect from the above is less than the benefit of improving the price.

The SSS have stated that they are against the Budapest Securities suggestion to operate a warrant support fund.

Work on secondary market effects and issues is continuing, with the objective of ensuring that a liquid market with the best possible prices is provided. To this end, counter measures such as Mutual Funds are being considered.

#### *Issue 7      The ability of the Privatization Plan to support the Warrant Scheme*

The SPA does not have an expressed plan for privatizing State Owned Enterprises (SOEs) for the coming year. Several forms of privatizations can be used to fulfill the exchange of warrants for state owned assets.

The SPA currently has three options available to exchange assets with compensation warrant holders:

- Share Exchange through Brokerages.

For the first tranche, the SPA selected SOEs which had transformed into Rt's and have been privatized. The first tranche was selected by the SPA's

Asset/Portfolio Management Unit (APM) which controls the residual shares of privatized companies. These companies have a majority ownership in the private sector. Several factors limited the availability of shares supplied by the APM, such as prior commitments to original buyers and the company's profitability. Thus, this unit, which manages 130 companies, could only offer 10 companies that met the selection criteria of the warrant scheme. Four companies were chosen for the first tranche originally timed for 15 January 1992. The readiness of three of these companies is now being questioned by the State Security Supervisor.

For the second and subsequent tranches, the SPA is not focusing on selecting companies from the APM. The SPA is continuously transforming SOEs, it currently has a list of 380 SOEs which may be available for the warrant scheme. Although this list may seem lengthy, most SOE may not qualify for the warrant scheme due to equity size, financial condition, transformation date, etc.

The compensation law states that SOEs transformed after 11 August 1991 will have to submit 10% of their shares to the warrant scheme (20% for food production companies). The SPA's list is dominated by SOE which transformed prior to this date and subsequently not all 380 SOE qualify for the warrant scheme. The SPA has also stated that companies which have one buyer for 100% of the shares will not have to be submitted to the warrant scheme.

The 380 SOE were gathered from various privatization offices at the SPA. They come from the active and spontaneous groups. Since the SPA has decided to pursue Self Privatization instead of active privatization, this number will decrease over time. The number of cases to be privatized under spontaneous system can not be accurately predicted;

■ Self Privatization.

The SPA has changed its strategic plan to focus on privatizations through self privatization. The first phase of self privatization, which is planned for an 18 month period, is to sell approximately 400 small SOE with a total equity of 25 billion HUF. The average size of a small SOE in this context is 63 million HUF. It is envisioned by the SPA that the majority of small SOE will be sold to employees of the firm. The SPA mentioned that the first phase is a continuous process and the number of SOE included in the list to privatize increases daily. The SPA said it would accept 50% of the purchase price in warrants but this percentage can increase.

The second phase of Self Privatization is proposed to begin in April 1992. This program will have a length of 36 months. The 650 SOE have a total equity between 175 to 200 Billion HUF with an average SOE value of 270 million HUF. Although these SOE are attractive to employees, it will be difficult for a consortium of employees to purchase their employer. If these SOE transform into Kfts, there are minimal problems as the employee (or other investors) names are written into the articles of association. If the SOE transforms into an Rt, then the SPA has to receive prior approval from the SSS to distribute shares. At the present time, the Self Privatization Unit believes that most middle size SOE will want to transform into Rt companies;

■ Pre Privatization Unit.

The Pre-Privatization group auctions small stores owned by the SPA. 100% ownership of these small stores has been transferred to the SPA if the state enterprise was established by the state. If the business was established by a local government, then the SPA retains 50% of the proceeds of the sale of the stores.

The small stores are being auctioned by local authorities on behalf of the SPA. Person interested in acquiring a store usually apply for "E-Hitel" bank loans since these loans carry a subsidized rate of interest. The E-Hitel loans have an interest rate of 75% of the basic rate.

If the store is owned by the state, the SPA can accept the full purchase price less expenses in compensation warrants.

Where the local government had established the business, the exchange of warrants for property can be up to 50% of the purchase price. The full purchase price is transferred to the SPA, and the SPA keeps the warrants and transfers the cash to the local government. Currently under review is whether or not the SPA could make monthly installments to the local government in lieu of a lump-sum cash payment. Also under review, in conjunction with the Ministry of Finance and National Bank of Hungary, is the interest rate that would be paid on the monthly installments - is it either the market rate or the E-Hitel rate.

Issue 7 - Summary

The SPA does not have a specific plan for SOE to support the warrant scheme but has several means by which it can marshal its resources. Privatization is a continuous process with which the warrant scheme will have to be integrated. However, if it is found necessary to increase the rate at which companies become available to satisfy the needs of the warrant holders a lead time of at least 4 to 6 months would be required.

3. Operational Actions

*Issue 8 OKKH planning for the issue of warrants*

The latest estimate (30 January 1992) of the number of decrees to be issued by OKKH is about 900,000. The regular release of warrants is expected to start sometime in March, (a test run of 350 decrees was held in December 1991). However, the rate at which they will be issued is not known and accordingly no comment can be made on the adequacy of OKKH's or Budapest Securities' arrangements.

The completion of OKKH's work is partially dependent upon the claimant producing adequate documentation, making it difficult to produce a forecast with a high degree of confidence. With this being the case the WAU will have to be able to monitor the situation on a regular basis to be able to assess the adequacy of the shares being made available to the warrant holder.

The OKKH budget has been reduced at the same time as the volume of the applications has increased dramatically. The consequences of this are not yet clear.

*Issue 9      Capability of the OKKH/Budapest Securities computer system*

OKKH has subcontracted the home office's computer system operator TAKISZ to record the application forms. This is a two phase process during which OKKH is to code the application forms and send them to TAKISZ for data input. At the time of writing this report, around 900,000 applications had been coded and recorded on the computer system.

The next stage is for the lawyers to begin the regular issuing of the decrees. There are 5 terminals in each office for 10-20 lawyers. It has not been decided whether the lawyers will use the computers directly or there will be operators to process paper input. There are no estimates of the systems maximum capacity. The computer system has programs that will try to set up a priority among the cases in order of the difficulty of reaching a decision. This is the only help the system can provide at the moment.

The output of OKKH's system are the decrees which describe the value and the bank office location where the warrants will be issued. The rest is Budapest Securities' responsibility (see also Issue 1).

*Issue 10      Availability of shares to cover the first tranche of warrants*

Although about 350 claims are to be satisfied by the availability of warrants, the first significant tranche has been delayed until sometime in March due to the workflow problems within OKKH.

So, given the delays in OKKH and in privatization, revised plans are required to synchronise the schemes.

The expected content of such a plan is:

- the forecast match between the shares to be available and the projected value of warrants that will be used to participate in privatization;
- the timetable requirements for lead-in privatization activities to take place, such as the appointment of intermediaries, production of audits, prospectus, issue of shares etc;
- "cash flow" forecasting based on the real value of the SPA assets involved.

Issues raised by Judit Toth of Budapest Bank concerned the mechanism for warrant participation in issues already traded, and whether the allocation procedures after offers are closed could be achieved within the 1 week available given the complications of warrants.

*Issue 11 Standards and controls within the brokerage system*

The SSS are concerned that the Budapest Securities/OTP network have a big advantage in selling their services. Warrant holders should know that they Budapest Securities have no special role in the usage of warrants and that there is no obligation to use their services.

To ensure that warrant holders receive a fair service, there is a need to monitor the standards and procedures which affecting the quality of service, such as:

- providing information;
- providing investment advice;
- the processing of purchases and sales for investment purposes;
- plans for investment schemes enabled by the recent legislation on mutual funds;

It is also advised that the degree of investor protection be assessed and that the warrant holders have access to a complaints and arbitration procedure.

*Issue 12 Controlling the risk of Fraud*

Since there is very little in place in systems terms (apart from the OKKH/Budapest Securities side, see Issue 11), there are few on which to base an analysis of the risk of fraud.

This study will be carried out once the operational system is better defined.

*Issue 13 Requirements for termination of warrants*

The WAU must identify the business requirement for reliable termination of warrants by:

- imposing controls on the collection and destruction of warrants;
- confirm which options for termination apply to each redemption route;
- obtain agreement on responsibilities for warrant termination with Budapest Securities'/OKKH systems.

*Issue 14 How should the WAU be organised*

The WAU itself will report to a Director of the SPA (Slosar Gabor) who will also control Asset Handling. Of the two other SPA directorates, one will contain legal, PR and finance functions, while the other will be mainly concerned with privatization work.

The role, responsibilities, structure, staffing, systems and support needs for warrant administration within the SPA will be addressed by one of the tasks defined in Appendix VI.

Accounting requirements were discussed with Eva Pesci (SPA Chief Accountant) on 25 November. While warrants are taken into consideration when carrying out economic planning and budgeting, there is currently no requirement to account for warrants to the Ministry of Finance. It is possible that this position might change, and they require advice on the SPA accounting mechanisms that should be put in place.

Our recommendations are detailed in section 5.2 of the main body of this report.

### *Issue 15      Legal obligations of the Institutions*

#### **The Social Security Administration**

Draft legislation exists for the payment of annuities in exchange for warrants. Eligible persons are defined in the law, as will be the calculation of the annuity. The Ministry of Finance expects that the annuities to be paid out of privatization income, but they will make up any shortfall. A monthly transfer of cash to the Social Security Administration will be made, that administration being responsible for the distribution of the annuities together with any pension due.

#### **The Cooperatives**

The Ministry of Agriculture have not yet given us any information. It is possible that the cooperatives will not accept the warrants at face value during the land auctions. The law says nothing about such an obligation, though the additional voucher scheme applying to the purchase of agricultural land may contradict them on this matter.

#### **The Banks**

There will be discussions with the representatives of the commercial banks and the National Bank about the E-loan. The question of ownership between the state and the local governments is not yet resolved. This may have an effect on the percentage of the warrants that can be accepted by the banks, as the part of the purchase price that belongs to the local government might have to be paid in cash. We have been advised that there is no legal obligation on the banks.

#### **The Local Authorities**

There has been no coordination between the SPA and the local governments about the warrants up till now. Many of the local governments are waiting for the new Apartment law. This is due in the first half of 1992. The local district governments we have asked have no plans yet about the usage of the warrants.

# HUNGARY'S WARRANTS PLAN

## A PROPOSAL FOR AN URGENT PR/COMMUNICATIONS PROGRAM

prepared for DRT Hungary  
by Ernest S. McCrary/EmiCom  
16 Dec. 91

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## 1. OBJECTIVES

The purpose of this report is to propose a communications and public relations plan for the launching of "compensation coupons" or "warrants", which are securities to be issued by the government to individuals as restitution for family properties seized by former regimes since 1938.

Distribution of warrants is scheduled to begin January 15, 1992.

## 2. BASIC BACKGROUND ON THE WARRANTS SCHEME

Warrants may be used in place of cash in numerous ways, for investments in pension funds, apartments, land, businesses, shares of publicly traded companies, etc. It is assumed that some individuals also will sell their warrants on a secondary market for cash, at prices which the Budapest Stock Exchange hopes to establish and support with public listings. Not all of these investment procedures are regulated yet (the case of annuities, for example), and this creates additional problems in explaining how warrant holders should use their notes.

The State Privatization Agency (SPA) is a party to the warrant scheme because of its overall responsibility for the liquidation of state-owned assets. The SPA also will be directly involved by designating certain state (SPA-owned) companies for privatization. These companies will issue shares--some of which will be available for exchange for warrants. Currently only four such companies have been identified, and only one of those already has publicly traded shares.

It is estimated that 500,000 individuals may be eligible to receive warrants, with a combined face value of 45-50 billion forints (about US\$600-\$700 million). So far, only about 120,000 claims worth 6 billion forints (US\$85 million) have been processed. These estimates are changing rapidly, and should be taken only as a rough indicator of the scope of the warrants program.

### 3. TARGET GROUPS

The audience for this information campaign can be divided into five groups:

- a. individuals who will receive warrants for properties lost by themselves, their parents or grandparents
- b. professional intermediaries, such as bankers and brokers, who will be the agents to deliver the warrants and to orient the warrant holders in how to make use of these securities
- c. general public opinion: Even among those who will not receive warrants, attention will be focused on the way the warrant scheme is conducted. This will be taken as an indicator of the government's seriousness and ability to fulfill its commitments for restitution and privatization in general. A disorderly warrants program will have a negative impact on public opinion overall.
- d. media representatives and influential commentators whose ideas can be transmitted to the groups listed above
- e. officials of the various government agencies involved in the overall warrants process--but whose coordinated information needs have not yet been addressed

#### 4. KEY UNDERLYING PROBLEMS

There are three main difficulties in implementing a warrants information program immediately:

- a. low levels of interest in and residual information about privatization and the compensation plans, among both beneficiaries and non-beneficiaries
- b. the short time period remaining before warrant deliveries are to begin on January 15, 1992; to avoid confusion, the information campaign obviously should begin at least some days before warrants are available on a large scale (a small symbolic delivery of warrants to 1,000 people already took place in early December 1991)
- c. lack of coordination among the governmental and private organizations involved in creating, issuing, delivering, investing and trading the warrants.

#### BACKGROUND

A September 1991 opinion survey conducted for SPA by the Szonda Ipsos Research Institute shows that only 30% of the 3,000 people interviewed nationwide could give a full and correct definition of privatization. Only 16% knew the name of the SPA as the agency responsible for privatization.

Regarding the warrants scheme, 39% said they were entitled to such payments. Of that group, 48% were planning to apply for compensation. Half did not know that payments would be made with bonds, not cash. The average anticipated value of these settlements was 370,000 forints, or about US\$5,000. Excerpts from that study follow.

## About the survey

On commission from the State Property Agency, in September of 1991 the Szonda Ipsos Media, Opinion and Market Research Institute conducted a public opinion poll on a 3000-person sample, representative of the adult population of the country. The interviews used standard questionnaires and personal interviews. Prior to this survey, in August of 1991 we had started a series of surveys on the subject of privatization, using a 1000-person sample. These surveys will be conducted regularly at monthly intervals. The results of these surveys appear in the publication titled Privatization Barometer.

In devising the questionnaires used in the present research--in those subject areas where it seemed appropriate--we used the experiences and data gathered during the surveys begun in August. This was done partly in order to take advantage of the long-term analysis thus made possible, and partly, because the previous survey could be treated as preliminary research.

The more significant data are summarized in tables, or represented in figures. We would like to mention here that the data may refer to any of three groups of persons who participated in the research: those who were questioned, those who responded to the question (including those who gave definite answers and those who answered with "I don't know"), and those who gave definite responses alone. The data are always projected onto the specific group of persons participating in the survey which seems most appropriate, judging by professional considerations. The group referred to is indicated in the caption of the table or diagram. The group most frequently referred to--in contrast to standard polling practice--is not that of the people who gave definite answers, but those who responded in whatever fashion. This is because--due to the nature of the topic--the proportion of those who answered with "I don't know" was higher than would normally be found. This proportion also varied according to the question, and therefore it cannot easily be disregarded. The questions or alternative answers cited in quotation marks in the titles of the tables and diagrams, or at some points in the text, are taken directly from the questionnaires, because we regard it as important to know precisely what questions were asked, and how they were answered by the interview subjects.

### Privatization and Public Opinion

Thus far, the general public in Hungary has not been greatly concerned with the privatization process. In our opinion, two factors are largely responsible for this. First of all, the day-to-day difficulties of making a living, particularly the financial burdens on the general population, leave little room for any other matters of interest to arise. In general, the attention paid to public



Table 37

Desirable proportion of foreign ownership  
(Average data supplied by those making an estimate)

males	28
females	27
<hr/>	
between 18-39	28
between 40-59	28
over 60 years old	28
<hr/>	
those living in Budapest	29
those living in provincial towns	28
those living in villages	28
<hr/>	
primary school educated	28
secondary school graduates	28
higher education graduates	26
<hr/>	
unskilled workers	28
skilled workers	29
office workers	27
intelligentsia, higher management	28
<hr/>	
those who know what privatization is	29
those who basically know	27
those who dont know	27
<hr/>	
total	28
<hr/>	

Compensation and privatisation

X More people stated in a previous public opinion poll that they were planning to make a claim for compensation than have so far done so - at the time of writing this study 39% of those questioned stated that either he himself or his

parents or grandparents had property, for which he was entitled to compensation. In the first half of September 48% of these people were planning to apply for compensation. (See Table 38.).

A significant part of those interested were quite ignorant about compensation. Only every second person knew that demands for compensation would be satisfied uniformly by way of compensation bonds. 48% mentioned this method, while 6% mentioned some other possible forms of compensation, too. 15% were not able to answer this question. (See Diagram 26.).

When those carrying out the survey told them that, in accordance with the law, the only form of compensation was the provision of compensation bonds, they said they were expecting bonds to the value of approximately 370, 000 forints (on average). These data are more suspect than usual, because a large number of people did not attempt to make an estimate. (See Table 39.).

Table 38

'Did you, your parents or grandparents have any land or other property, on the basis of which you expect compensation now '

'Do you plan to apply for compensation '

(Proportion of the affirmative answers expressed as a percentage. First column - answers of all those questioned. Second column - answers of those who think themselves entitled to compensation.)

	had application property planned	
males	39	52
females	38	45
<hr/>		
between 18-39	33	44
between 40-59	42	51
over 60 years	45	49
<hr/>		
those living in Budapest	29	47
those living in provincial towns	37	51
those living in villages	46	46
<hr/>		
primary school educated	41	46
secondary school graduates	37	49
higher education graduates	46	51
<hr/>		
unskilled workers	39	43
skilled workers	39	47
office workers	34	48
intelligentsia, higher management	38	52
<hr/>		
total	39	48

Table 39.

What is the value of the compensation bond that you expect ?  
(Average sum in forints expected by those who were planning  
to apply for compensation)

males	399.264
females	331.441
<hr/>	
between 18-39	594.598
between 40-59	270.231
over 60 years old	270.781
<hr/>	
those living in Budapest	617.708
those living in provincial towns	309.048
those living in villages	332.710
<hr/>	
primary school educated	287.158
secondary school educated	485.076
higher education graduates	238.519
<hr/>	
unskilled workers	156.970
skilled workers	663.537
office workers	525.789
intelligentsia, higher management	239.672
<hr/>	
total	370.783

Those interested seldom want to use the compensation bond for the purchase of state property. Only 8% of those who have already made a decision in this respect were planning to do so. Most of those involved wanted to sell (29%) or spend these bonds on the purchase of land (21%), or exchange them for a life annuity (19%). (See Diagram 27.). On the basis of this it is not likely that the implementation of the compensation law will give a new impulse to the privatisation of state property.

## **5. ACTION PLAN**

### **5.1 Inter-Agency Task Force**

The immediate priority is to organize an inter-agency "Warrants Launch Task Force", which would be a committee with one or more representatives from the key groups involved: SPA, the Budapest Stock Exchange, Budapest Securities, OKKH (State Savings Bank), the Deloitte/DRT "warrants team" and possibly the Finance Ministry.

The purpose of this task force, which could be chaired by SPA Communications Director Csaba Gelenyi, would be to define exactly what information must be given to each warrant holder. This information must fulfill certain legal requirements, and still be easily comprehensible to even lesser-educated villagers.

### **5.2 Booklet**

Once defined, this information should be transformed by a skilled journalist or direct marketing expert into a booklet which describes the warrant holder's investment alternatives in clear and simple terms. This booklet should be distributed to all post offices, branch bank offices and brokerage offices around the country. It would be turned over to anyone requesting a copy for study before taking delivery of the warrants. Additional copies should be available from brokers at the time warrants are handed over. The objective is to guarantee that all warrant holders get at least the same basic information package explaining how to use their warrants. (Each brokerage would be free to add whatever additional proprietary materials judged to be useful.)

### **5.3 Posters**

Posters should be prepared for display in the same locations--post offices, banks and brokerage firms--advising potential warrant recipients to request the free information booklet.

### **5.4 Information Center**

A temporary Information Center should be established in a location to be determined by the Inter-Agency Task Force to receive questions and complaints from the warrant-holding public. This address and/or phone number would only be given to warrant recipients when they obtain their warrants. It would not be available to the general public. It is anticipated that this Information Center would need to function for about six months, but termination of this service could occur sooner or later--depending on the volume of inquiries.

### **5.5 Seminar for Brokers**

A seminar should be arranged before Jan. 15, 1992, for brokers and other financial intermediaries involved in the warrant distribution process. This should be coordinated with the Budapest Stock Exchange and Budapest Securities, with a program content aimed at the information needs of smaller brokerage houses. This event should last half a day, and could be repeated in interior cities if the Inter-Agency Task Force determines such a need.

### **5.6 Television and Radio News**

Interviews should be scheduled with television and radio channels no later than January 10, 1992, to announce the impending launch of the warrants. The Inter-Agency Task Force should determine who would have primary responsibility for serving as the group's spokesperson.

### **5.7 Other Media Contacts**

Similarly, the Task Force should designate a principal spokesperson for dealing with print media, giving background interviews and explanatory materials to key economic journalists and others covering privatization/business/political issues. An attempt should be made to negotiate a pact with the press at this point to help in the distribution of essential information about the plan. Criticism and political commentary on the plan would, hopefully, be channelled into a separate, subsequent line of coverage.

### **5.8 Press Kit**

To facilitate the work of both print and electronic media, a basic press kit should be prepared to outline the warrants program and answer the most obvious questions about its operation.

### **5.9 Advertising**

A limited amount of television, radio and newspaper advertising should be planned. The main message of this campaign would be that the warrants program is coming, that it represents a fulfillment of the government's, that it is part of the plan to modernize and democratize Hungary's economy and that details are available for warrant recipients at banks, post offices and brokerage houses.

### 5.10 "Indirect" Advertising

The Task Force should attempt to enlist the support of writers and producers of television programs to include the warrants scheme in the subjects they cover. This would obviously apply in the case of debate-type talk shows, and possibly popular entertainment shows. The intention is to secure this sort of cooperation as a public service, without payment--although some producers have a rate structure and charge a fee for this sort of "merchandising". This would be a matter for negotiation. A meeting with one of the writers of "The Neighbors", a popular Hungarian soap opera, indicates there might be some interest in collaboration. The audience profile of this show, geared toward older females, would make it particularly effective for reaching one of the most important groups of warrant recipients in an effective, non-didactic way,

## 6. TIMING

### **Week of Dec. 16, 1991:**

Task Force holds its first meeting, and identifies basic informational elements which should be part of the orientation brochure.

Agrees on "poster" concept or other mechanisms for immediate mass notification of warrant recipients.

Contacts local PR and advertising companies about possible collaboration.

Selects writer to start putting orientation text into brochure format.

Discusses items 5.1-5.10, assign tasks, solicit and evaluate additional ideas

### **Week of Dec. 23, 1991:**

Gets rough draft of brochure and poster text, layout. Approves or requests changes.

Arranges to handle logistics of Information Center, media contacts, seminar for brokers.

Makes agreement in principle with local PR consultant and advertising agency, subject to approval of funding.

Requests bids for printing booklets, posters.

### **Week of Dec. 30, 1991:**

Gets semi-final draft of brochure, poster copy.

Decides on content of media kit.

Updates all other items in 5.1-5.10.

Contacts postal, bank and brokerage authorities about poster/booklet distribution.

Consults with PR, advertising advisers.

### **Week of Jan. 6, 1992**

Approves final draft of booklet, poster.

Selects printer; delivers material for typesetting.

Acquires emergency funding for at least part of project.

Expands activity with PR consultant, ad agency.

Brings all items in 5.1-5.10 to near-operational status.

### **Week of Jan. 13, 1992**

Receives printed materials; begins distribution; LAUNCHES CAMPAIGN.

## 7. RESOURCES REQUIRED

Estimated cost and time requirements of proposed program elements:

- 5.1 Set up Task Force  
No external cost
- 5.2 Booklet: initial press run of 200,000  
printing and paper @ \$.40 each = US\$80,000  
distribution--US\$10,000 + some free distribution by banks, brokers
- 5.3 Poster: 10,000 copies  
printing and paper @ \$1 each = US\$10,000  
distribute with booklets
- 5.4 Information Center  
use in-house facilities and staff of one or more Task Force participants  
operation costs (supplies, postage, phone)--6 x US\$2,000/mo. = US\$12,000
- 5.5 Seminar  
get corporate/bank sponsorship; no cost
- 5.6 Television, radio news  
interviews; no direct cost
- 5.7 Other media contacts  
interviews, no direct cost
- 5.8 Press Kit: 500 units  
paper and printing--US\$2,500
- 5.9 Advertising  
Total 20 mins. of TV @ avg. US\$1,000/min = \$20,000  
Print media: equivalent 5 pages @ \$5,000/page = \$30,000
- 5.10 "Indirect" Advertising  
negotiate arrangements; no cost

## 7.1 OTHER RESOURCES

Local Public Relations consultant. Estimated work requirements for entire campaign, including responsibility for writing and producing booklet, is 40 person-days. At avg. billing rate of US\$300/day, = US\$12,000

Foreign Public Relations consultant, whose mission is to help design program details, verify work progress, confirm allocation of resources. Requirement: one visit of five working days in early January. Deliverable: full progress/evaluation report.

Travel and living expenses:

air & ground travel--\$2,000

hotel--6 x \$150 = \$900

meals--6 x 50 = \$300

communications, misc.--\$300

consulting fees--5 x \$700 = \$3,500

TOTAL--US\$7,000

**GRAND TOTAL--US\$183,500**

for additional information or clarification, contact:

Ernest S. McCrary

EmiCom/Washington

phone (202)223-8098 fax (202)966-6975

16 Dec. 91

## Memorandum

28 November 1991

To: Dr. Lajos Csepi  
From: Cliff Dean  
Subject: Co-ordination of the Compensatory Warrant Scheme  
Reference: The discussion of our initial findings:

DRT are assigned with defining the needs of the SPA in meeting the requirements of the Warrant Compensation Scheme (WCS). After an initial two week investigation we are preparing an analysis of activities to be carried out and, have identified a number of issues that need to be resolved before the SPA can:

- be assured of the feasibility of starting the WCS on 15 January 1992
- identify its operational requirements as part of the overall scheme.

However, in carrying out this work a particularly important issue has arisen which we feel should be brought to your immediate attention namely, the need to **co-ordinate** the activities and responsibilities of the various governmental bodies involved in the WCS: SPA, Indemnification Office, BSE, MOF, and Social Security Administration. The *attached schematic* illustrates both the complex demands of the WCS and the essential interfaces between the governmental bodies.

Some specific examples of this are:

- the need to synchronize the timing and value of warrants issued (Indemnification Office) with the companies made available for investment (SPA, BSE)
- the need to co-ordinate the publicity, education, and training programs required by different governmental bodies
- ensure the broker network satisfies both the warrant issuing needs of the Indemnification Office and provides services to support SPA's requirements, while at the same time maintain the standards and controls laid down by the BSE
- establish mechanisms for the identification and prevention of fraud across all operations.

The success of the WCS, as well as the success of SPA's specific areas of responsibilities, depends on the effective co-ordination of these activities.

**There does not appear to be anybody with responsibility for the overall scheme.**

In our view and from our experience this lack of co-ordination puts the whole program at risk. The establishment of a co-ordination role is essential, whether performed by an individual or by a representative body.

We are raising this issue now as you may wish to discuss it with the heads of the other governmental bodies.

DRT will be happy to advise further on this or respond to any questions you may have.

## TASKS FOR SET-UP OF THE SCHEME

### Introduction

Before warrants are issued in mid-March, a number of tasks must be completed. The aims of these tasks are:

- to provide the essential set-up work in preparing the institutions involved with the scheme;
- provide a firm basis from which to develop longer term operational plans.

Three tasks are aimed at supporting the scheme as a whole. There are five subtasks which support the SPA in establishing the Warrant Administration Unit (WAU).

External consulting advice will be required to assist in the planning activities and ensuring that the scheme remains on course. We therefore suggest that these tasks will be performed under the direction of a single Project Manager with a team of consultants of the necessary expertise. Since the focus of the work arises from the Needs Analysis performed for the SPA, it is suggested the team report to the SPA's Warrant Administration Unit with ad hoc advice from the USAID-funded Privatization Advisor.

The period over which these tasks will be carried out is expected to be four to six weeks. It is recommended the USAID funding be requested to support the tasks. The tasks are:

- carry out initial public relations and training activities;
- establish SPA/WAU data requirements and collection procedures;
- produce an operational model for analysis of company asset availability and statistics on warrants issued;
- develop a systems requirements plan;
- develop position descriptions, assist with recruitment and recommend training for WAU staff;
- advise on the accounting information requirements of the SPA in order to record and report WAU results;
- assess the risk of fraud and establish procedures for control of fraud;
- develop an operational plan for the scheme.

## Level of Effort for Consultancy

Skill Category	Person Days
Project Manager	30
PR/Communications Specialists	20
Financial Analysts	50
Systems Analysts	15
Human Resources Development/ Training Development Specialists	20
Total Level of Effort	135

Descriptions of each task, providing a terms of reference for the set up project, follow. Each task is defined using the headings of:

- objective and background;
- approach;
- deliverables.

### Task 1: Initial Public Relations and Training Tasks

#### Objective and Background

The proposal for an urgent PR and communications program, attached as Appendix IV, stresses the need for regular and consistent information to be supplied to the public about the warrant scheme. As a first step to addressing this need, an inter-agency task force has been established. However, to date, a plan of action for public relations has not been adopted.

In addition to publicity, short, half-day training programs should be designed which enhance the awareness of the scheme. Targets for training include the staff of the SPA and other implementing institutions. The objective is to develop methods by which staff will advise warrant holders on the way they may use their warrants.

One specific request from the SPA is that training in fund management and the use of mutual funds be delivered before the warrants are issued.

#### Approach

PR and training assistance will be provided by a communications consulting firm and training advisors. They will assist the PR Task Force to:

- adopt and execute a detailed work plan using the Public Relations report endorsed by the initial PR Task Force meeting;
- develop and produce PR and training materials for the information booklet, posters and other media;
- begin initiatives to reach target groups including warrant holders, professional intermediaries, general public opinion, media representatives and influential commentators, and officials of the implementing agencies.

Financial analysts will work with the training advisors to design a one day workshop on fund management, discussing the potential for use of mutual funds as part of the warrant scheme and describing the mechanics for making the mutual funds work.

#### **Deliverables**

- PR Task Force meeting schedule and agenda
- Information Booklets and Posters
- Training materials
- Fund Management workshop

### **Task 2: Establish WAU Data Requirements and Collection Procedures**

#### **Objectives and Background**

The objective of this activity is to define the operational data requirements of the WAU. The WAU will have to coordinate information on the supply and demand relating to warrants with the SPA and other Government agencies involved in the Warrant Scheme with the objective of obtaining that information on a timely basis.

It is expected that the primary use of this data will be for the operational model.

#### **Approach**

A team of financial analysts will assist by undertaking the following work steps:

- review of the current links between the WAU and the line departments within the SPA (active privatization, spontaneous privatization, investor-led privatization, pre-privatization, self-privatization), the asset/portfolio management unit and the financial accounting unit;
- review of the current links for data collection between the WAU and the Government institutions involved with the Warrants: Indemnification Office (OKKH), Social Security Administration, Ministry of Agriculture and others;
- based on the work already carried out and given in section 7 of this report, establish the technical information needs of the WAU to conduct its activities, both internally from the SPA and externally from the governmental institutions;
- establish procedures for coordinating the flows of technical information from these privatization units to the WAU.

#### **Deliverables**

- Diagrams of information flows
- A policies and procedures manual for data collection by the WAU, including sample forms for gathering and presenting information.
- Guidelines on the data required by the OSC

### **Task 3: Produce an Operational Model for the WAU**

#### **Objectives and Background**

The WAU is responsible for planning, monitoring, analyzing and evaluating the progress of the warrant scheme to maintain a balance between demand (number of warrant holders seeking company shares in exchange for warrants) and supply (number of company shares available for exchange). Accordingly, the WAU requires an analytical tool for processing the information identified as a result of Task 2.

It is proposed that an automated operational model be developed in which raw data can be entered and compiled. The model's purpose is to produce management reports to assess the success of the scheme in meeting its objectives. The result of these assessments will be recommendations to SPA management and the Operational Steering Committee about actions required to keep the scheme on course.

The model must be in place as soon as possible to allow the WAU to develop the program of the assets eligible for investment by warrant holders.

#### **Approach**

A financial modelling specialist will work with the asset management department and the information management department of the SPA to develop the operational model. The team will undertake the following work steps:

- determine suitable spreadsheet software for development of the model in conjunction with the SPA;
- based upon the data required, design and program data entry screens;
- design and program the analysis routines;
- design and program management reports (system output);
- assist in the recruitment of a technical specialist to serve at the WAU to assume responsibility for maintenance of the model;
- test the model and provide training in its use to the WAU (linking with the overall WAU training described in Task 5).

#### **Deliverables**

- Operational Model
- Model specifications and programming documentation
- User manual
- Training Materials

#### **Task 4: WAU Systems Requirements Analysis**

##### **Objective and Background**

In addition to the operational model, described above, the WAU will require support from other SPA information systems in order to perform its functions.

##### **Approach**

A systems requirements analyst will examine the possibility for links between the current SPA management information system, other data bases and information sources and the WAU. They will:

- review the functions which require systems support;
- using the data requirements analysis mentioned above, examine automated systems requirements;
- define the hardware and software needs of the WAU;
- develop recommendations for the most cost effective methods of information processing. Evaluate options such as linking with the current SPA local area network and other systems;
- assist the WAU in acquiring the systems it requires.

##### **Deliverables**

- System configuration plan
- Equipment list including indicative costs

#### **Task 5: Position Descriptions, Recruitment and Training for WAU staff**

##### **Objectives and Background**

The needs analysis team has identified new positions within the WAU; in the proposed operations unit and policy analysis unit. More complete definition of the roles, responsibilities, and expectations of these positions as well as the skill level of qualified candidates, is required.

Once job descriptions are complete and receive approval the head of the Warrant Administration Unit, recruitment both within the SPA and outside should begin.

It is expected that these tasks will be completed with the assistance of the SPA. If necessary, additional guidance will be available from the Privatization Advisor.

Recruitment is linked with training as, despite careful selection, the necessary skills may need to be developed or sharpened through training. Both "on-the-job" skills transfer and formal classroom training should be utilized to augment personnel capabilities.

To fill gaps in skills required, it is expected that external advisory support will be needed during the initial six months of operation.

## **Approach**

A human resources development specialist will work with the Head of the WAU to:

- describe each job, identify the skills required, and estimate the salary range for each position;
- identify sources for advertisement and place the advertisements;
- solicit nominations of potential internal candidates with the appropriate background from the SPA's directors;
- screen and interview potential applicants;
- extend offers of employment.

Once recruitment is completed, refined identification of training needs specific to the WAU staff will be a first step to increase the ability of the WAU to perform its tasks. The needs identification can be completed by a training development specialist with current SPA resources which include the SPA's training unit, the European Community Training Advisor, and the USAID-funded Privatization Advisor. Work steps will be:

- assess the current skill level and compare to skills required;
- identify training response to include special courses or use of an external advisor on a short-term basis to provide skills transfer;
- verify that WAU training beyond initial start up is linked with the overall SPA training schedule.

## **Deliverables**

- Job descriptions
- Interview guidelines
- Training plan and schedule

## **Task 6: Examine the SPA's accounting information requirements**

### **Objective and Background**

The SPA's Finance Directorate will have to account for warrants and modify their returns and budgets accordingly. WAU set-up tasks should include preparation for these requirements, which must recognize the need to agree the policy and presentation of warrant data with the Ministry of Finance.

## **Approach**

An accounting/financial management specialist familiar with the SPA's current accounting systems will investigate the reporting requirements and assist the SPA's accounting staff to adjust and extend their procedures to include this new responsibility.

The tasks include:

- provision of a workshop on the different accounting methods that could be applied to warrants, their effect in relation to the privatization scheme, and selection of a preferred method;
- together with appropriate staff from the SPA's Finance Directorate, meeting with the Ministry of Finance to agree how warrants should be accounted for and any amendments to existing returns;
- assisting the SPA to define the required changes in its accounting system to accommodate warrants and any new reporting requirements;
- advise on the manual and automated system links between the WAU and the accounting function, and assist in their implementation.

## **Deliverables**

- Description of accounting and reporting requirements
- New or amended record keeping system
- Procedures and documentation for automated or manual reporting system

## **Task 7: Assess Risk of Fraud and Develop Procedures to Control Fraud**

### **Objective and Background**

As operational plans are developing, and it becomes clearer how the process through which physical warrants and information about warrant will be managed, it is necessary to develop procedures to minimize the risk of fraud. Procedures will be developed to authenticate warrants, verify warrant holders' legitimate claims, and for destroying certificates.

### **Approach**

The financial analysts will:

- chart the flow of warrant documents through the redemption system, review procedures for collecting and destroying warrants;
- identify points of potential fraud and assess level of risk at each point (fraud audit);
- identify points where verification of warrants takes place;
- develop procedures for validating warrants;
- develop procedures for destruction of warrants;
- develop test cases for identifying fraud.

### **Deliverables**

- Fraud risk assessment
- Plan to minimize risk of fraud

### **Task 8: Develop an Operational Plan**

#### **Objective and Background**

At the completion of set up, there will be a significant base of information for developing a full operational plan. The topics in the plan are likely to include: creation of a PR Campaign; development of a Training Program; Hardware and Software Procurement and Maintenance; and Advisory Assistance in specialized areas such as fund management and market analysis.

The purpose of the task is to devise a coherent plan for the continued operation of the scheme, including the identification of the additional funding needs, both for local currency and foreign currency costs.

#### **Approach**

The Project Manager, with the consultant team, will assess and monitor the level of preparedness to execute the scheme during the set up phase. A full operational plan, including projected costs, will be developed for approval by the warrant scheme Coordinator and Operational Steering Committee.

#### **Deliverables**

- Operational Development Plan
- Terms of Reference for Advisory Assistance
- Budget for Operations