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FINANCIAL SERVICES Ltd.



**REVIEW OF THE STATUS OF THE
POLISH CAPITAL MARKETS**

Funded by:

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WARSAW

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EXECUTIVE SUMMARY

We are pleased to submit this report which was prepared at the request of the United States Agency for International Development (USAID). The purpose of this report is to present and analyze Polish capital markets with an objective of outlining areas where US Government assistance might continued or be provided.

A major element of free-market development is the efficient allocation of capital, particularly to growing small- and medium-sized private enterprises. If the private sector is to continue to grow, its capital needs must be satisfied through free-market mechanisms which allocate capital efficiently and in much larger quantities. The Government of Poland and its institutions realize these needs, and Poland is entering the next stage of development, an intense and more sophisticated stage.

In our updated report we present information on capital markets that have existed in Poland since the economic transformation which started in 1989, the direction of development of those markets and the involvement and influence of different institutions and market participants. Our report was prepared in the first half of 1996 and relies on information that was published at that time. In the last section we present recommendations to USAID/Warsaw on priority areas for assistance.

In particular, we discuss the following issues in this report:

- **Part 1.**

Governmental and non-governmental institutions which play a significant role in the development of capital markets: the Polish Securities Commission, Warsaw Stock Exchange, National Depository of Securities, Ministry of Privatization, Ministry of Finance, Banking sector and National Bank of Poland, institutional investors, brokerage houses, Brokers' and Investment Advisors' Association, Brokerage Houses' Association, Over-the-Counter Market, Mass Privatization Program, mutual funds and Commodities Exchange.

- **Part 2.**

An assessment of related laws: securities regulation, the Act on Bonds, tax system on capital markets, Foreign Exchange Law, accounting and audit, derivatives instruments, and the legislation governing forms of business enterprises.

- **Part 3.**

A look at the constraints faced by small- and medium-sized enterprises (SMEs) and options for raising capital. While the SME sector and the private sector are not exactly the same, they are virtually so. Most large companies in Poland are still owned wholly or in part by the State.

- **Part 4.**

Donor-funded activities that may affect the development of the capital markets: PHARE Program, Know-How Fund, World Bank, European Bank for Reconstruction and Development, International Finance Corporation, Polish-American Enterprise Fund, USAID.

- **Part 5.**

Recommendations for future USAID assistance - to assure it is focused and effective and has the most impact on the development of capital markets in Poland.

In preparing this report we received cooperation from many institutions and organizations. A few key resources included representatives of the Polish Securities Commission, Warsaw Stock Exchange, Ministry of Privatization, Ministry of Finance, Brokerage Houses' Association, Association of Brokers and Investment Advisors, Commodity Exchange, and Central Table of Offers Company (CeTO). In addition, we want to thank Ms. Eve Anderson and Mr. Mark Kraczkiewicz of USAID for their encouragement and assistance and our editor, Ms. Suzi Kanyr Hagen of Fiesta Consultants LLP. Without the help of those noted and many others, this report could not have been prepared.

The views and recommendations in the body of this report are the authors' and do not represent an official position of the United States Agency for International Development (USAID).

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INFORMATION ON FINANCIAL SERVICES

Financial Services Limited (FSL), a joint venture between a Polish bank and an American investment company, was founded in March 1992. It is the first Polish enterprise specializing in professional administration, consulting, accounting and transfer agency services for capital market institutions.

FSL operates in an area of financial services that is new to the Polish business community and beyond the scope of banking and other services previously provided by large financial institutions. In contrast to consulting companies which may have only a single client in the specialized field of financial services, we are one of the few firms in Poland providing consulting services in the field of financial accounting while simultaneously actively participating in such operations. In addition to fulfilling our duties as a transfer agent for Pioneer First Polish Trust Fund, FSL actively seeks to apply superior solutions to financial challenges in the Polish banking and institutional infrastructure.

The main activity of the firm to date has been cooperation in the creation and servicing of Pioneer Funds and the maintenance of a distribution network for these funds. Specifically, we developed a legal and organizational framework for the funds, adapting Western practices to the realities of Polish capital markets. As a result, we have gained a great deal of experience in the fields of law, administration, finance and accounting as related to the functioning of financial institutions.

The staff of Financial Services is composed of 93 highly educated and experienced individuals, supplemented by technical and financial specialists. Our dynamic team maintains close contact with representatives from leading financial institutions, such as banks, brokerage houses, the Ministry of Privatisation, and the Warsaw Stock Exchange, and presents a high degree of professionalism. Our staff utilizes modern organizational and office techniques which, in combination with their dedication to excellence, guarantees that projects are carried out efficiently.

Our firm is equipped with the latest computer technology. Our transfer agency software operates on an IBM RS/6000 computer system with an Ethernet network utilizing PC terminals. The system allows total automation and facilitates data analysis and control. Our computers perform under the direction of a professional staff.

FSL's success in servicing the Pioneer Fund is proof that the organizational methods and operations' framework developed by our staff are suitable for the demands of a large enterprise. Financial Services currently is exploring opportunities to expand its activities to servicing other clients.

We have developed on a wide scale a consulting service based on our experiences. We already have successfully realized contracts for the Ministry of Privatization, the Polish Securities Commission, the Association of Polish Banks and the USAID, among others.

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Part I.

**INSTITUTIONS AND THEIR
IMPACT ON POLISH
CAPITAL MARKETS**

1. POLISH SECURITIES COMMISSION (PSC)

The Polish Securities Commission (PSC) was established by the Act on Public Trading in Securities and Trust Funds of March 22, 1991, (called hereinafter the Polish Securities Law). Like its counterparts in the industrialized countries, the PSC was empowered with the task of protecting the interests of investors by monitoring the day-to-day activities of publicly traded securities and of regulating the securities markets in general. Additionally, given the general lack of knowledge regarding capital markets, investor education has been a priority of the PSC.

1.1. Size and Structure of PSC

The Commission consists of seven persons, including a Chairman and two Deputy Chairmen. The Chairman is appointed by the Prime Minister at the joint request of the Finance Minister and the President of the National Bank of Poland (NBP). The statutory members include representatives of the President of the NBP, Minister of Finance, Minister of Privatization and the Chairman of the Anti-Monopoly Agency.

The Commission usually meets regularly twice-a-month to amend existing legislation or to implement new regulations. The regulatory activities of the PSC can be described as follows:

- “Issuing regulations: Rules of the PSC and Ordinances of the Chairman”,
- “Issuing individual decisions, such as permits to bring securities into public trading, licenses to operate brokerage firms and trust funds or revocations of such,
- “Presentation of its official views on issues related to market regulation, market environment, and market development”¹

To carry out these regulatory functions efficiently, the Commission regularly examines the financial reports of publicly-traded firms. Furthermore, the Commission works in parallel with the brokerage industry to establish and monitor self-governing rules for the industry and a code of conduct for brokers and investment advisors. In this regard, representatives of the Brokers’ Association, the Warsaw Stock Exchange (WSE), the National Depository of Securities (NDS) and the Brokerage Houses Association have been given advisory rights in regulatory matters.

The Commission’s day-to-day activities are carried out by well-trained staff. The PSC currently employs 95 people. The PSC is organized in the following manner:

- Authorization Department
- Corporate Finance and Economic Analysis Department
- Law Department
- Enforcement Department

¹ The Polish Securities Commission, Annual Report 1994, page 14

1.2. Authorization Department

The Authorization Department assesses applications concerning the establishment of any new stock exchange, examines and registers individual brokers, grants permits to brokerage firms and trust funds, and surveys the market.

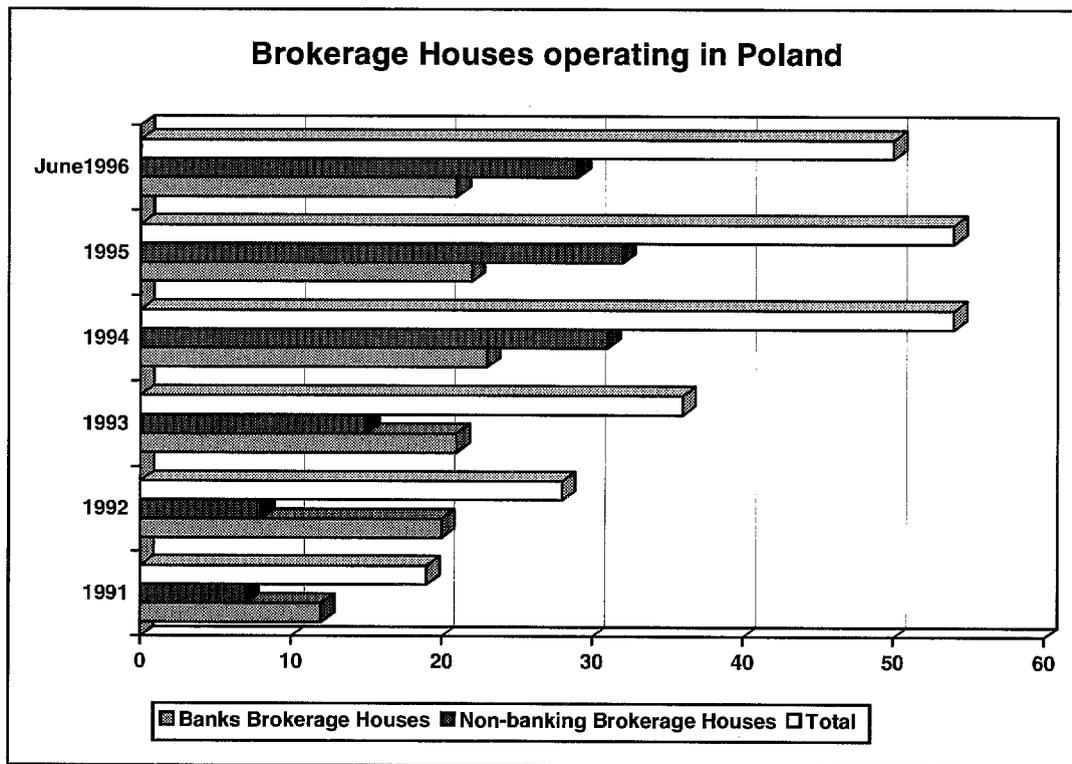
Authorization of Stock Exchanges

Currently, the only operating stock exchange in Poland is the Warsaw Stock Exchange. In the future, any entity attempting to organize a new stock exchange in Poland would be required to file an application with the Polish Securities Commission. If the PSC approves the application, the Commission would then request the Prime Minister to grant the stock exchange an operating permit (license). If the stock exchange is subsequently found guilty of violating the Polish Securities Law, the Commission also has the authority to revoke the operating permit.

Authorization of Brokerage Firms

At this writing, 50 brokerage firms operate in Poland, 29 of which are independent and 21 of which are departments within banks.

Chart 1



Source: PSC data

In the process of issuing licenses, the Securities Commission conducts an extensive and in-depth evaluation of the activities that the new firm will undertake, its proposed ownership structure, information regarding the management of the firm, including certification that the management personnel have no prior criminal records. The proposed

firm also must submit details of its organizational structure and technical facilities to demonstrate that it possesses, separate from any parent firm, its own capacity to undertake the envisaged activities. Firms that are either fully or partly foreign owned are allowed to apply to the Securities Commission for licenses to operate provided that such businesses are already otherwise legally registered in Poland. Six foreign-owned brokerage firms operate in Poland:

- Citibrokerage Sp. z o.o.
- Creditanstalt Securities S.A.
- CS First Boston S.A.
- DM AmerBrokers S.A.
- Raiffeisen Capital and Investment Polska S.A.
- IB Austria Securities S.A.

Unlike the United States, no restrictions prevent banks from undertaking brokerage activities. As mentioned earlier, the only restriction currently imposed by the Securities Commission is that the securities operations be both organizationally and financially separate from the banking operations. However, the PSC is pushing for a total separation of banking and brokerage activities; i.e., the PSC wants each brokerage house to be a separate legal entity.

Once licensed, any subsequent changes affecting the brokerage firm's structure and/or operations must be reviewed and approved by the Commission before the firm is allowed to implement the changes.

The Commission subsequently has extended the scope of licenses of a number of operating brokerage firms. Specifically, 31 existing brokerage firms were granted licenses for sale and redemption of units in trust funds, 12 for sales and purchases on the block bond market, 25 to acquire securities in their name for their own accounts.

Authorization of Trust Funds

Currently four mutual funds operate in Poland. The first Polish mutual fund was created in 1992 by the Pioneer Group of Funds of Boston, USA. On 24 April of the same year, the brokerage department of Bank Pekao S.A. was given the mandate to create outlets through which customers could purchase Pioneer Mutual Fund units. The units officially were made available to the public on July 28, 1992.

Three other funds were authorized during 1995 - Pioneer II, investing in government debt instruments, Pioneer III - Aggressive Investing Trust Fund, and Korona.

The Korona Fund, a joint-venture between Austria's Creditanstalt and Bank Gospodarki Żywnościowej, made its debut on August 7, 1995. It is classified as a balanced fund targeting long-term capital appreciation through investments in Polish equities and fixed income. (See Part I, Sec. 13.)

Fidelia Fund and Przymierze Fund were authorized in the first quarter of 1996.

Authorization of Individual Brokers

All candidates must pass stringent examinations set by the Securities Commission. The exams are designed to test the candidates' knowledge and suitability to engage in securities trading. The Polish Securities Exam is considered to be among the most difficult to pass (those in a position to compare say that it is more difficult than the Series 7 in the US). This is reflected in the "pass rate" which has fluctuated around 11 percent. The comprehensive four-hour examination involves multiple-choice questions which have been set by the Securities Commission Examination Committee. The examination covers the following topics:

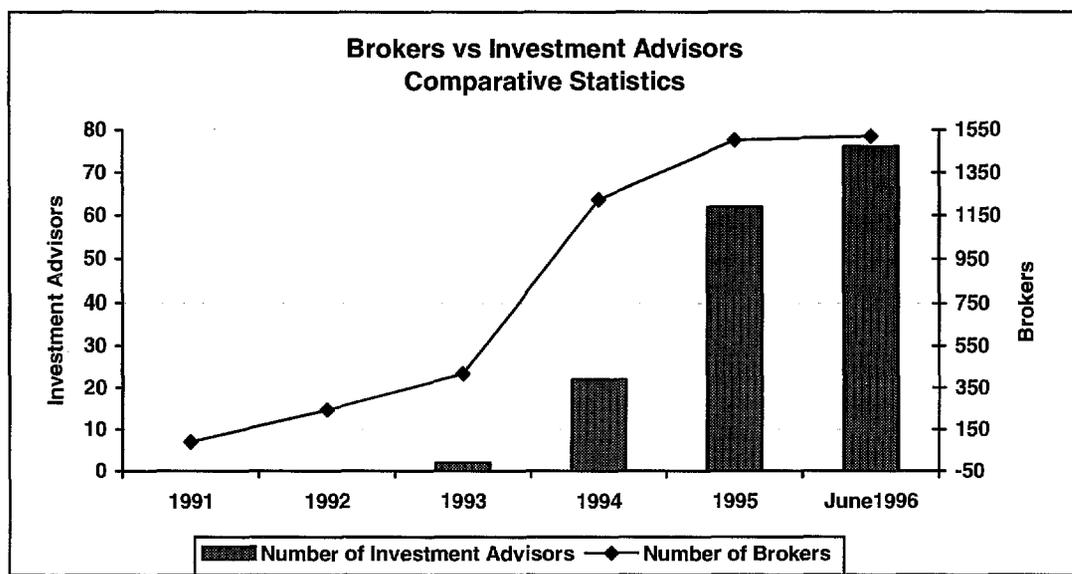
- Regulatory law,
- Capital markets,
- Financial instruments of the capital market,
- New issues
- Market institutions and intermediaries,
- Trading system: Clearance and settlement,
- Investment strategy,
- Unit trusts, collective investment plans,
- Brokers professional ethics.

Upon successful completion of the Securities Commission examination, the candidate has to apply for inclusion on the Commission's Register of Brokers, thus enabling the candidate to work as a broker. The Register of Brokers provides potential investors with a means to ensure that the broker handling the transactions is authorized to do so. The Register verifies the name of the brokerage firm where the broker is employed. When a broker moves from one firm to another, both he and his new employer must notify the Securities Commission so that the Register is kept up-to-date. A broker's name is removed automatically from the list if he/she has not worked as a broker for five consecutive years.

Brokerage firms may employ others in addition to licensed brokers. In fact, a majority of persons who accept customer orders are not licensed. Staff supporting brokerage operations must be assigned as assistants to specific licensed brokers who then are responsible for their activities.

This less restrictive approach has enabled brokerage firms to develop a customer base and begin to act as financial intermediaries more quickly than if all persons engaged in securities activities had been required to be licensed through the examination process. The number of brokers totaled 1,519 in June 1996.

Chart 2



Source: PSC data

Authorization of Investment Advisors

Investment advisors, as the name suggests, may provide clients with investment advice and recommendations, something that licensed brokers currently are not allowed to offer in Poland. Like the examinations for brokers, the Securities Commission also organizes exams for investment advisors. The very basic requirements include extensive knowledge of law, finance, available financial instruments, risk factors, securities analyses, portfolio theory, management and ethics.

Over the last three year, more than 500 applicants attempted the aforementioned examination. Of these, currently 76 are now fully licensed investment advisors, working in brokerages houses.

Market Surveillance

The Polish Securities Law empowers representatives of the Securities Commission to enter a brokerage firm and inspect its books and records. If irregularities are detected in the course of a routine audit, further investigation may be made with greater disclosure. Members of both the Authorization and Enforcement departments visit firms in-between trading sessions to ensure that proper procedures are in place for handling both on- and off-exchange transactions.

1.3. Corporate Finance and Economic Analysis Department

The Corporate Finance and Economic Analysis Department prepare prospectus standards and approves prospectuses in conjunction with individual public securities offerings. This function is of particular importance and casts the Securities Commission in the role of the custodian of product quality. The Department is primarily interested in all financial information relating to each individual security. This record is available for dissemination to the public.

A company planning to issue its shares through a public offering must apply for permission from the Securities Commission. The application must be accompanied by a copy of the managing body's resolution to issue securities and an offering prospectus. The Commission reviews the information included in an issuing prospectus. The prospectus must include the following information in this order:

- Details about the issuer, specifically an introduction stating the type and number of shares to be offered, the nominal value and issue price, and rights which accompany them,
- Information about the issue itself including its legal basis, nature and amount thereof and any risk factors,
- Information concerning the public offering, period of offering and financial organizations,
- Information about the administration and management of the issuing company,
- Information about the issuer's operations, activities, products, assets, research and development, licensing and credit arrangements, recent development and future prospects,
- Issuer's plans and prospects for growth and development,
- Sufficient detail about the financial state of the issuer.

These requirements are defined in the Ordinance of the Council of Ministers of October 11, 1994. These prerequisites and subsequent amendments are in total compliance with the requirements of the European Union (EU) Listings Directive and the Resolution of the International Organization of Securities Commissions with regard to developing uniform standards of auditing to ease the issue of cross-border securities by multi-nationals. The most recent changes include:

- Disclosure of information on dilution resulting from new issues,
- Disclosure of information on transactions with related parties (large shareholders, members of the board of directors, and the executive staff),
- Broader information on the prospects of the issuer, especially an estimate of profits for the next 12 months,
- Consolidated financial reports for issuers which are holding companies with controlling interests,
- Cash flow statements in place of funds flow (sources/uses) statements,
- Foreign entities may have their reports audited following the International Auditing Standards issued by the International Federation of Accountants and their cash flow statements presented in accordance with the International Accountancy Standard No. 7 - Cash Flow Statement,
- Issuers also are obligated to determine the exact date on which they will submit their periodic reports. Issuers listed on the Warsaw Stock Exchange may not disclose their periodic reports before the end of a trading session,
- Quarterly financial reports no longer have to be audited (only semi-annual reports to be reviewed and annual reports to be audited),
- Detailed scope of disclosure in respect to entities which are in control of issuers, including among others, the obligation to publish consolidated financial reports for the capital group,

- When the controlling entity is foreign, its financial report may be audited by a foreign auditor. However, a Polish auditor must confirm that the report is in accordance with Polish accountancy standards,
- Public companies may present a short-form prospectus when issuing new shares, provided that they have fulfilled their information obligations for the previous 18 months.²

The Commission sets and enforces rules on potential issuers' disclosure of data which is essential in making a reliable appraisal leading to an informed decision by investors. The Commission evaluates the validity of this information. This process also constitutes the basis for admitting such securities for public trading.

If the information is satisfactory, the Securities Commission grants a permit to the issuer within two months of the application's filing.

When a permit is obtained, the issuer must deposit all the securities with an authorized depository. An abstract of the prospectus must be published in at least two national daily newspapers.

In October 1995, a new Securities Commission unit was formed to evaluate the information memorandum of companies wishing to be listed on the Over-the-Counter (OTC) market. This follows an Ordinance that was approved by the Council of Ministers on October 11, 1994, and is a supplement to the Act on Public Trading in Securities and Trust Funds. The Ordinance details conditions to be fulfilled by a prospectus and an information memorandum. The information memorandum is obligatory for companies that want to be listed on the OTC market. A majority of the Mass Privatization Program companies are expected to be listed on the OTC market.

The information memorandum must include (among others) the following:

- Information about the issue, its legal basis, nature and amount thereof and any risk factors,
- Number and type of the securities to be traded publicly, their nominal value and issue price, and rights which accompany them,
- Information about the issuer,
- Body offering the shares for trading,
- Name of the company which prepared the memorandum,
- Manner in which shares will be offered,
- Prospects of development of the issuer,
- Audited financial report for the previous year,
- Information about the court where the issue is registered,
- Type and value of the company's capital,
- Information on legal issues.

² The Polish Securities Commission, Annual Report 1994, page 16-17

1.4. Law Department

While the basic choices for the structure of regulatory and trading systems have been made, and initial procedures and requirements have been established, the long process of evolution has only begun. Considerable work is needed to complete the regulatory and legal framework, thus improving market flexibility and adaptability. The Securities Commission, given its central role in the development of market regulation, is well equipped to propose revisions or supplements to the laws regulating securities. This is a key function of the Law Department. In fact, the Commission is the main source of legislative initiative as far as securities markets are concerned.

The Securities Commission's amendments to the Act on Public Trading in Securities and Trust Funds, approved by Parliament in December 1993 came into effect on February 14, 1994. The Commission also has amended existing legislation relating to bonds which was subsequently approved on June 29, 1995, by the Council of Ministers and various parliamentary committees and superseded the previous Bond Law. The new law introduced mechanisms which facilitate companies financing operations through the issuance of debt.

The Law Department also prepared a draft decree of the Council of Ministers to separate the National Depository of Securities from the Warsaw Stock Exchange. This separation is a necessary step in the creation of the Over-the-Counter market. The separation subsequently was completed, and the Depository now can settle both stock exchange and OTC transactions. (See Part II, Sec. 2.)

New regulations in 1995 included:

- Amendments to the Act on Public Trading in Securities and Trust Funds.
- The Act on Bonds.
- The Ordinance of Council of Ministers in regard to operation of the OTC market.
- Ordinances and projects of ordinances of the Chairman of the PSC concerning:
 1. Detailed accounting regulations related to bank-affiliated brokerage houses, including balance sheets, income statements, cash flows, and additional information,
 2. Detailed accounting regulations related to non-banking brokerage houses, including balance sheets, income statements, cash flows, and additional information,
 3. Necessary information for the companies formally admitted to the public OTC market,
 4. Detailed accounting regulations related to trust funds, including balance sheets, additional information and other of trust fund statements,
 5. Specific criteria of accounting principles related to public companies,
 6. Information obligations included in consolidated financial statements of the public companies,
 7. Additional information included in financial statements of the public companies, but not banks,

8. Additional information included in financial and consolidated statements related to public banks,
9. Terms and conditions admitting derivatives to the public

1.5. Enforcement Department

The Enforcement Department has two sections: Surveillance and Investigation, and ensures fair trade and competition in the public trading of securities and proper protection of investors.

Surveillance inspectors attend all trading sessions at the Stock Exchange and are prepared to examine transactions for possible illegal or improper conditions. They verify order sheets and make sure that no irregularities exist in transactions.

A brokerage firm is obligated to notify the Authorization Department if there are any changes in the information contained in its original authorization application form. Details must be supplied regarding changes of its registered staff, the opening or closing of a branch, or major business developments such as the acquisition of more than 5 percent of the voting rights in any other company. Should the Authorization Department not be satisfied or require further information, the Enforcement Department becomes involved.

The Investigation section prepares documents for the presentation of cases to the Chairman of the Commission, who forwards them to the local Public Prosecutor. This close cooperation between the Commission and the Public Prosecutor's office has resulted in several formal indictments on charges ranging from minor violations of the Polish Securities Law to serious charges of price manipulation and insider trading. To help to educate prosecutors, judges, police and others, the Enforcement Department conducts regular training sessions on legal issues which may arise as a result of operating in the securities market.

The Investigation section also deals with complaints from investors who could not settle their grievances with the firms concerned. This division is also responsible for monitoring the press to ensure that advertisements are not misleading and that published information is consistent with that included in prospectuses submitted to the Commission.

According to the Polish Securities Law, the Commission may suspend or revoke a firm's permit for:

- Violation of the law,
- Failure to comply with the terms of a permit, or exceeding its limits,
- Failure to observe the principles of fair trade, or injury to the interests of the client.

The Commission has the right to suspend a firm temporarily in order to protect the interests of a client while it seeks out further information. A decision whether to revoke or confirm the suspension has to be made within one month. Disciplinary action taken by the Commission is published in a press release and in the Securities Commission Records at the end of the Commission's session.

Since its inception, the PSC has demonstrated its ability to be responsive to the market. The first significant case involved the failure by an issuer (Wedel S.A.) to disclose in a timely manner information regarding certain tax relief that had been received. Insider trading prior to the delayed disclosure was suspected. The PSC acted immediately and, in conjunction with the Stock Exchange, suspended trading in Wedel's securities until the information was publicly disseminated. After further investigation, the company was cleared of all charges and the suspension lifted.

Also in 1994, for the first time in its history, the PSC revoked a permit for a public offering. The company, Towarzystwo Ubezpieczeń i Reasekuracji Polisa S.A., failed in its statutory obligation to register a new issue with the PSC before issuance. Since then, the company has applied to the Commission and been accepted.

1.6. Development of International Relations

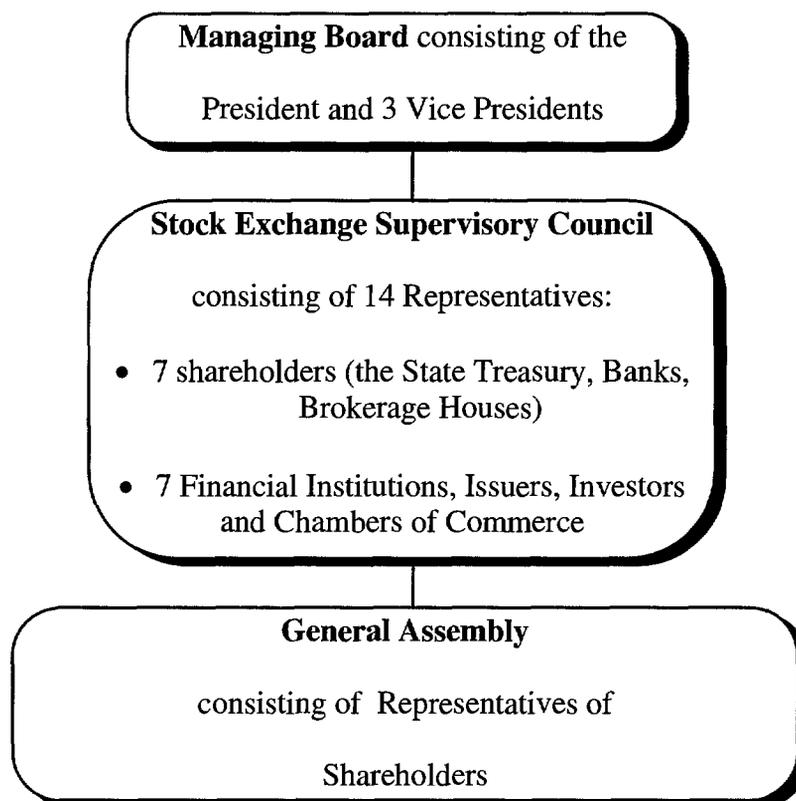
In addition to fulfilling its regulatory functions within the Polish securities market, the PSC also has been very active in helping to develop the securities industry as a whole. The Commission was well represented at the IX Annual Conference of the International Organization of Securities Commissions (IOSCO) held in Tokyo, Japan. The Commission has been a member of the IOSCO since 1990 and was selected as a member of the Executive Committee three times. The PSC also has been a leader among the Emerging Markets through its work on enforcement and exchange of information. The Chairman of the Commission and other high officials have made numerous trips abroad and have organized trips to visit the PSC for their colleagues in other countries.

2. WARSAW STOCK EXCHANGE (WSE)

After being closed for 52 years, the Warsaw Stock Exchange (WSE) reopened on April 16, 1991, as authorized in Article 54, Section 7 of the Act on Public Trading in Securities and Trust Funds. The present Exchange is heir to a long-established trading tradition in Poland. During the inter-war period, a total of six Polish commodity and stock exchanges operated, dealing primarily in securities, crops, foreign currencies and precious metals.³

2.1. Structure and Operations

The general structure of the Warsaw Stock Exchange is:



A member of the Warsaw Stock Exchange must be: an entity conducting a brokerage business, a shareholder in the Exchange and allowed to operate in the market. The Stock Exchange Board allows brokerage houses to operate on the Exchange if they employ the required number of brokers and are members of the National Depository of Securities. Currently, 36 banks and brokerage houses are members of the Exchange. Those brokerage houses that are not members of the Exchange have their orders processed through member brokerages.

³ Budzen, Dariusz M., and Frankowska, Anna M. *Prohibitions against insider trading in the United States and the European Community: Providing Guidance For Legislatures of Eastern Europe*. Boston University International Law Journal, Volume 12, Number 1, Spring 1994, pp. 1-3.

Originally the Exchange was formed as a joint-stock company by the State Treasury. At present, 43 banks and brokerage houses have minority shareholdings in the Exchange, while the State Treasury holds the majority stake (98 percent).

Only securities admitted to public trading may be listed on the Warsaw Stock Exchange. There are two markets on the WSE - the **main** market and the **parallel** market. All rules governing trading and disclosure are the same for both markets.

A decision to list a security on the main market is made by the Stock Exchange Supervisory Council based on these criteria:

- “(T)he shares are admitted to public trading by the Polish Securities Commission;
- the transferability of the securities is not limited (also known as “bearer”);
- the value of the shares to be introduced to the market is at least PLN 7 million (not less than ECU 2 million);
- the book value of a company whose shares are to be admitted is at least PLN 9 million but not less than the equivalent of ECU 3 million and, in the case of banks and insurance companies, at least PLN 15 million but not less than the equivalent of ECU 5 million;
- the value of the share capital of the company, whose shares are to be admitted, is at least PLN 4.5 million but not less than the equivalent of ECU 1.5 million and, in the case of banks and insurance companies, at least PLN 9 million but not less than the equivalent of ECU 3 million;
- the value of the shares to be admitted and held by shareholders, each of whom owns no more than 5 percent of the total number of votes at the general assembly, is at least PLN 4 million but not less than the equivalent of ECU 1.5 million;
- the shares mentioned in the point above constitute at least 25 percent of the total shares of the company;
- at least 500 shareholders hold the shares to be admitted;
- the company whose shares are to be admitted registered pre-tax combined profits for the past three financial years of at least PLN 3 million but not less than the equivalent of ECU 1 million and also registered a pre-tax profit for the last financial year;
- the application to admit securities covers all securities of the same type.”⁴

The parallel market is designed mainly for smaller companies with shorter track records. The listing requirements of this market are similar to those of the main market except with lower limits. Presented below are the distinct requirements for the parallel market:

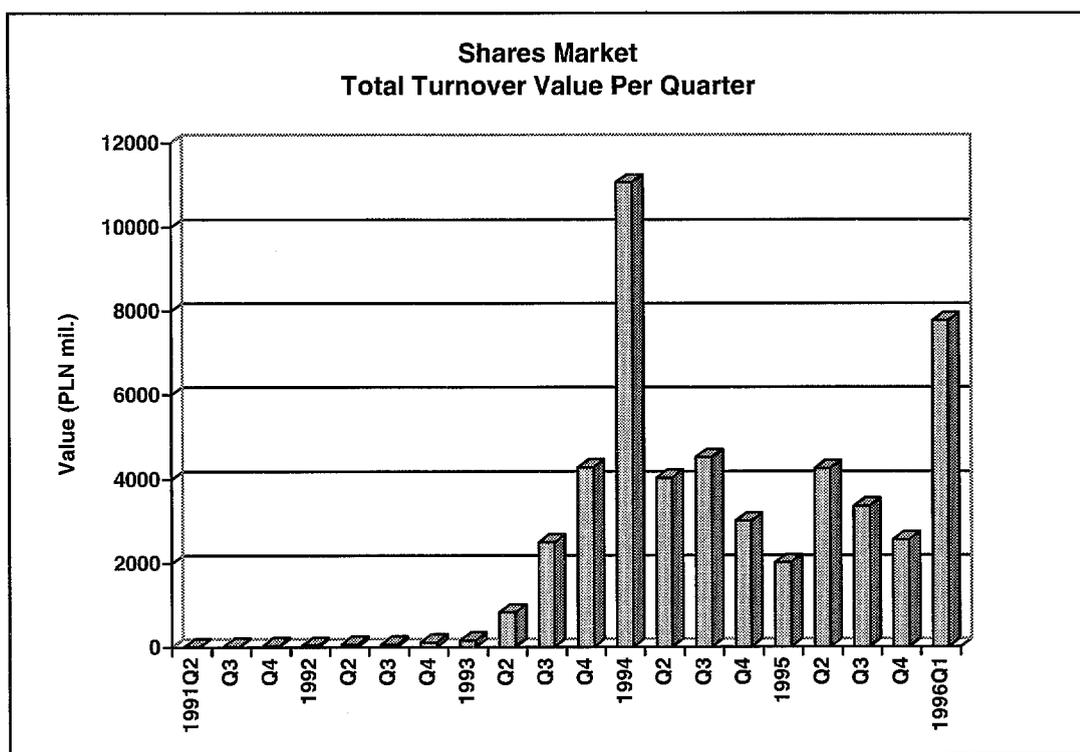
- “(T)he value of the shares to be admitted is at least PLN 2 million but not less than the equivalent of ECU 600,000;
- the book value of a company whose shares are to be admitted is at least PLN 3 million but not less than the equivalent of ECU 1 million (in the case of banks and insurance companies, ECU 3 million);
- the value of the share capital of a company is at least PLN 1.5 million but not less than the equivalent of ECU 500,000 (in the case of banks and insurance companies, ECU 3 million);

⁴ The Warsaw Stock Exchange, Operation & Organization July 1995, p. 3

- the value of shares to be admitted and held by shareholders, each of whom owns no more than 5 percent of the total number of votes at the general assembly, is at least PLN 1.5 million but not less than the equivalent of ECU 500,000;
- at least 300 shareholders hold the shares to be admitted;
- the company registered a pre-tax profit for the last financial year”⁵

As of June 1996, there were 83 public companies. The shares of 74 companies were listed on the Stock Exchange. The average trade volume⁶ (“turnover”) per session, as of May 1996, reached about PLN 123,0 million (approximately \$45.55 million), with an average of 27,639 orders and 9,596 transactions per session.

Chart 3



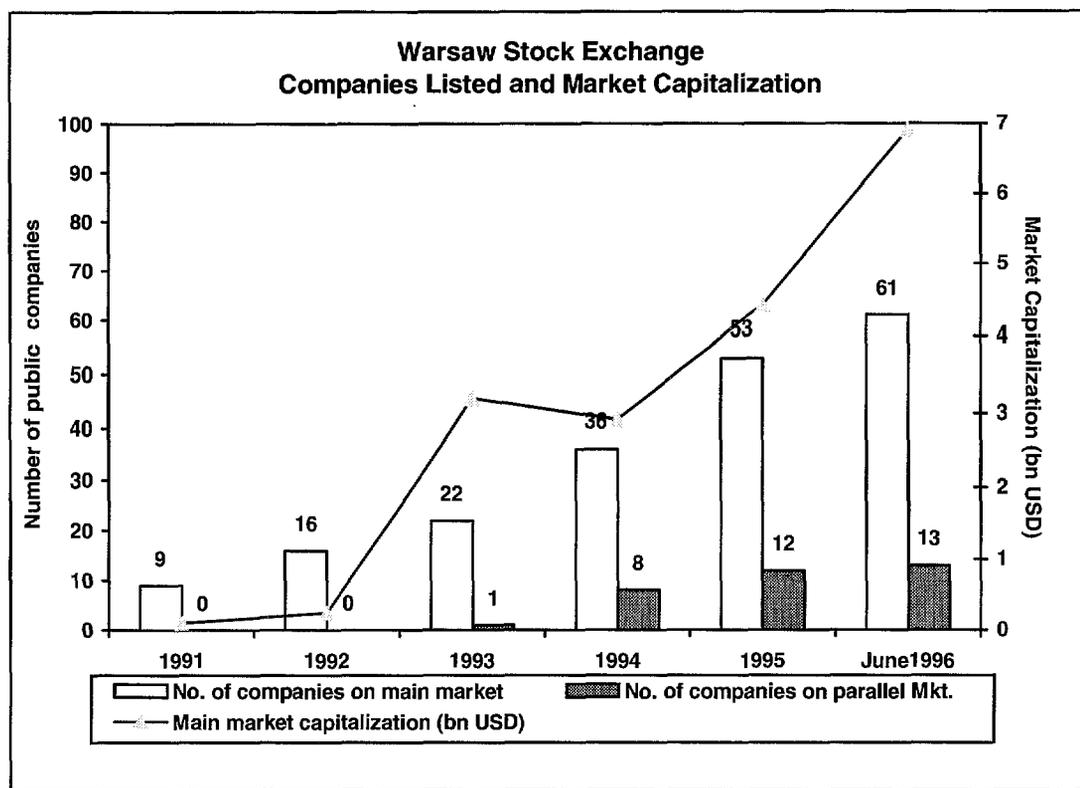
Source: Warsaw Stock Exchange - Annual & Quarterly Reports

In terms of the total value of equities traded, the Warsaw Stock Exchange is one of the largest of its kind in Europe. A 31-fold increase in market capitalization of the WSE has occurred, from \$142 million at the end of 1991 to \$6,91 billion as at June 3, 1996. This is shown graphically on Chart 4. The Exchange has seen more than 120 new issues, including a number of second and third offers, since its 1991 opening.

⁵ The Warsaw Stock Exchange, Operation & Organization July 1995, p. 3

⁶ It is important to understand that the WSE uses a double-sided transaction statistic for measuring trade volume or turnover, counting both the seller volume and the buyer volume, thus doubling the number presented in comparison to US and other western markets.

Chart 4



Source: Warsaw Stock Exchange - Annual & Quarterly Reports

2.2. Trading System

The trading system of the Warsaw Stock Exchange can be characterized as:

- Order driven,
- Centralized at a single Exchange site,
- Paperless.

The WSE currently trades five days a week for two hours each day, from 11:00 a.m. to 1:00 p.m.

During the trading session, a brokerage firm acting as a specialist advisor for the Stock Exchange plays a key role. Each issuer proposes a specialist firm to the Stock Exchange authorities (very often the same as its underwriting broker). Thereafter, this firm specializes in that particular stock.

Trading in stocks

Member firms collect orders and submit them via diskette or terminal entry to the Exchange on the morning of each session. The trading system is similar to the French "Par casier" or German "Einheitspreis" method of quotation. A computer tabulates the orders submitted and derives a single price per share at the end of the session. The pricing mechanism relies upon a simple algorithm identifying the price which maximizes the number of shares changing hands, subject to two restrictions: (1) The maximum price movement cannot be greater than ± 10 percent and (2) must minimize the difference

between the demand for and supply of that security. Once the price has been derived, specialists have a chance to correct any imbalances in the market for a given stock by either buying or selling from their own book or locating large investors willing to fill the imbalance at the set price.

Most orders are "limit orders" which define a maximum buying price and a minimum selling price. Other orders can bear the instructions "all or nothing" (in the event of orders being scaled down) and "at market". The "at market" price is the price that emerges as the quoted price of the stock at the end of the trading session; it is also sometimes referred to as the "day rate".

On December 18, 1995, a new type of order was introduced. Post-auction market orders (PCR is the Polish acronym) are non-competitive because they don't participate in the price-setting process. PCR orders may be sent to the WSE only before the session and are valid only for the nearest trading session; they may contain "all or nothing" clauses.

PCR orders are executed in response to a buy or sell imbalance occurring after a price has been established. These orders take priority over others after a session opens and executed based on the time they were received in the WSE computer system.

Trading in bonds

In contrast to stocks, two systems exist for trading in Treasury Bonds: a single price quotation on the main market and continuous trading on the block market. Each is described in more detail below.

- Single-price quotation

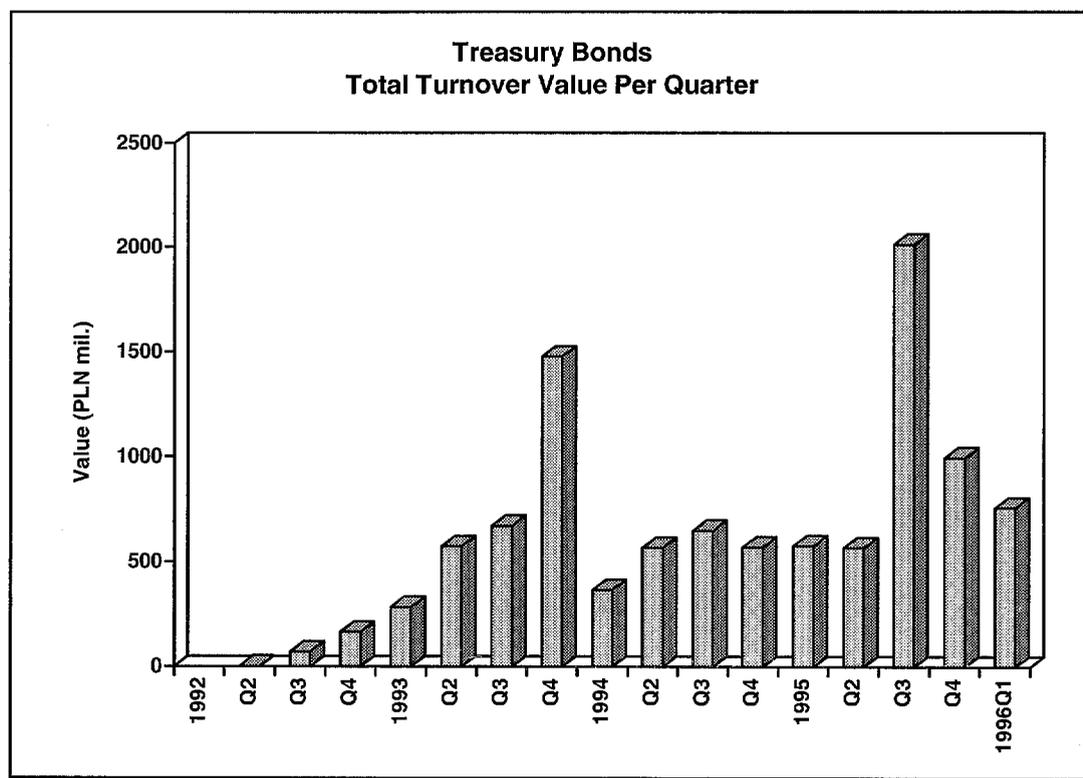
As of this printing, three series of one-year bonds and 11 series of three-year bonds were being traded using the single-price quotation method. This method follows the same principles as the equities market. The prices of bonds are quoted as a percentage of their nominal (face) value. This price is subject to change from one session to the next. However, the change is restricted to ± 5 percentage points. The settlement price takes into account the accrued interest (i.e., accrued interest is added to the market value).

- Continuous trading

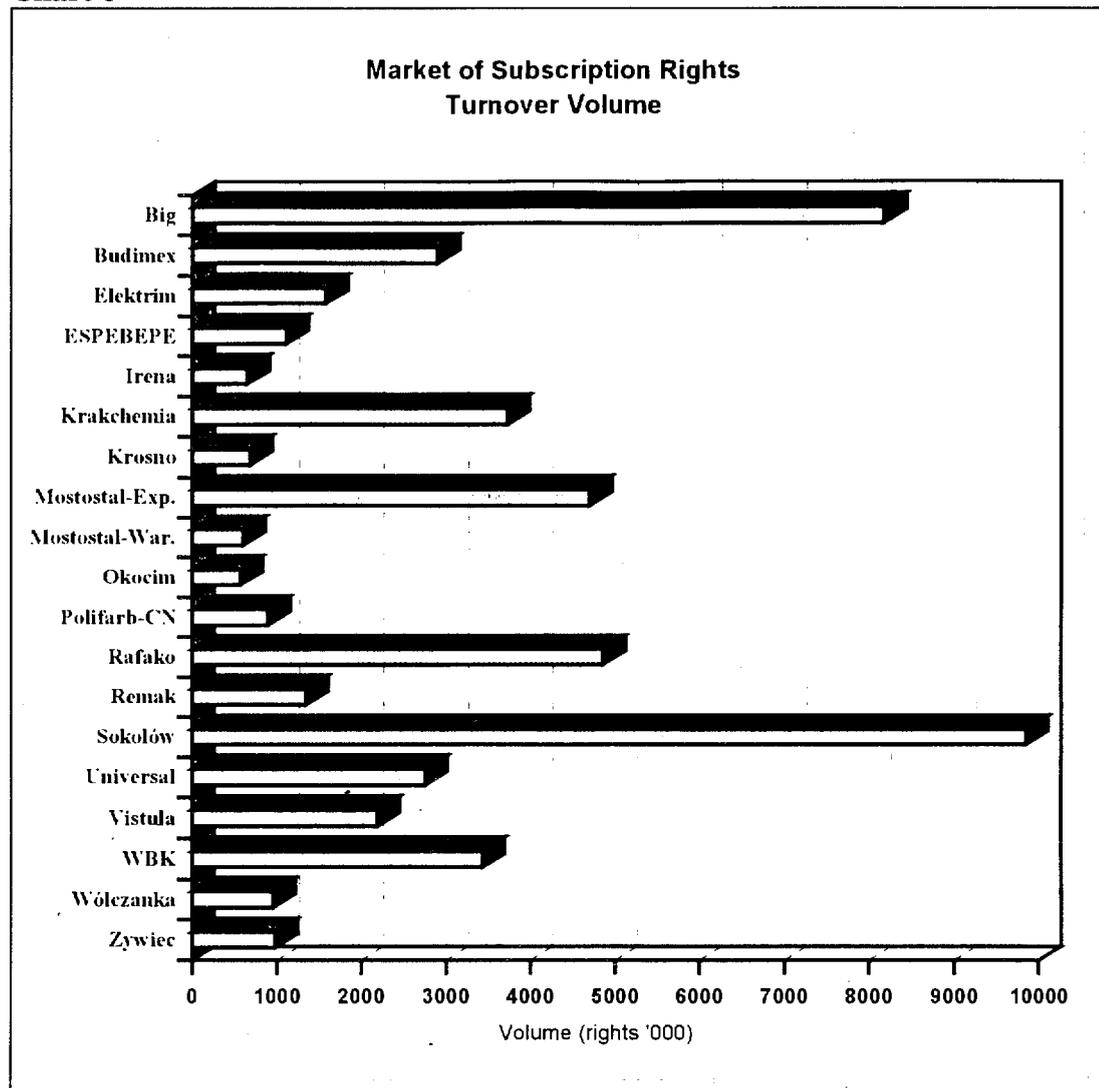
This system of trading treasury bonds was first introduced on June 15, 1992. Under this system of continuous trade (also known as the bonds block market), the major participants are large investors, primarily banks. Both floating and fixed interest rate bonds are traded on the Exchange. A transaction is expressed in terms of one block of par value PLN 10,000 (i.e., each block contains 10 bonds of par value PLN 1,000). As in the single-price market, a price is expressed in terms of a percentage of the nominal value of one bond. The opening price of the bond is based on the same principle as the single-price quotation system. Thereafter, the price changes with the arrival of new orders (thus the name continuous trading). At the end of each session, the Stock Exchange publishes the prices of all transactions concluded as well as the best buy and sell offers. Currently, three series of one-year, 11 series of three-year, and 2 series of ten-year Treasury Bonds are being traded on this market.

Fixed interest bonds commenced trading in May 1994. Two such types of bonds are traded on the Stock Exchange: eight series of two-year T-Bonds with two series bearing 18 percent interest and the remainder bearing 17 percent interest, and eight series of five-year T-Bonds with two series bearing 15 percent interest, four series bearing 14 percent and two series with an annual interest rate of 13 percent. Unlike the floating-rate bonds, fixed-interest bonds are considered to be high-risk financial instruments. The primary reason is the difficulty in accurately forecasting the inflation rate two to five years down the road. The risky nature of this instrument also enables one to use its volume of turnover and level of prices as a gauge of investor confidence in the direction of the economy. The following graph shows the overall growth in the bond market since 1992.

Chart 5



Source: Warsaw Stock Exchange - Annual & Quarterly Reports

Trading in Futures & Derivatives**Chart 6**

Source: Warsaw Stock Exchange - Annual & Quarterly Reports

No law specifically regulates the trading of futures and derivatives. The only futures transactions conducted on the WSE are trading in subscription rights which are guaranteed in the Commercial Code. Trading in subscription rights commenced on the WSE in February 1994. WSE regulations stipulate that if subscription rights are not specifically excluded in the General Meeting of a listed company, then they are automatically traded on the WSE, subject to admission of the new issue by the Polish Securities Commission. As of the end of 1st quarter of 1995, 19 companies quoted on the main market of the Exchange have had their rights traded on the Exchange. The total value of these trades equaled PLN 13,922,000.

The Securities Commission is drafting a law to regulate Futures and Derivatives Trading.

2.3. Indices on WSE

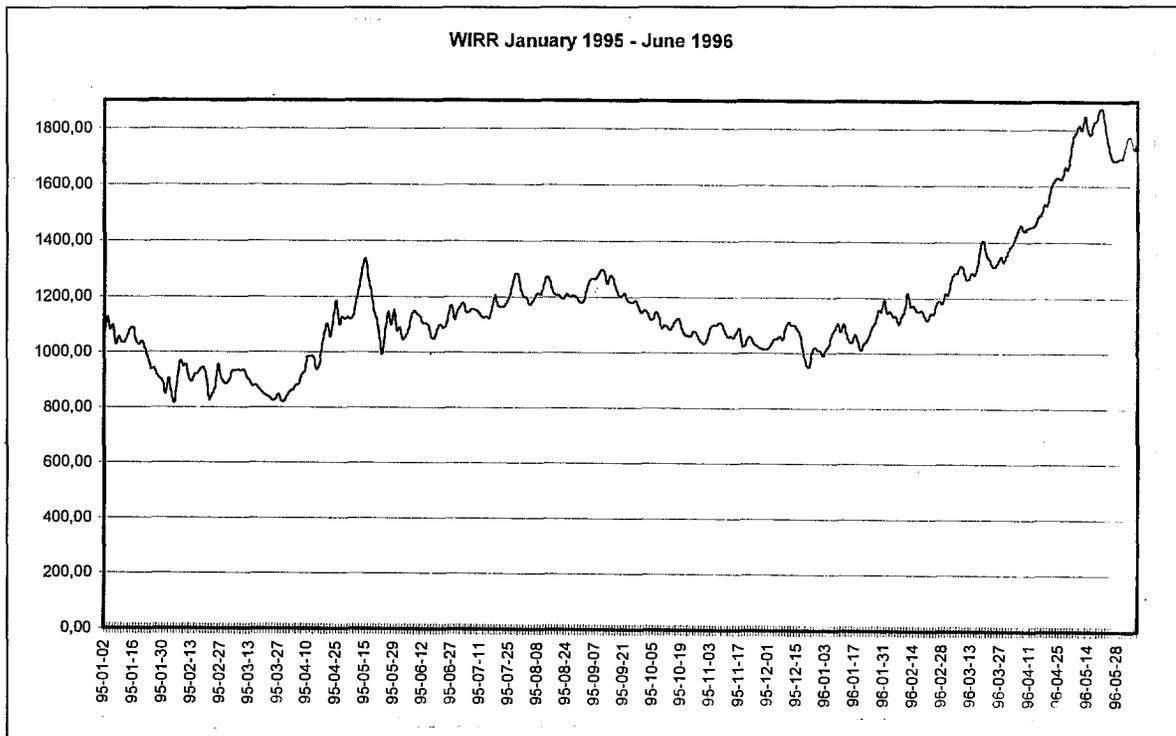
The WSE currently calculates three separate indices: WIG, WIG 20, and WIRR.

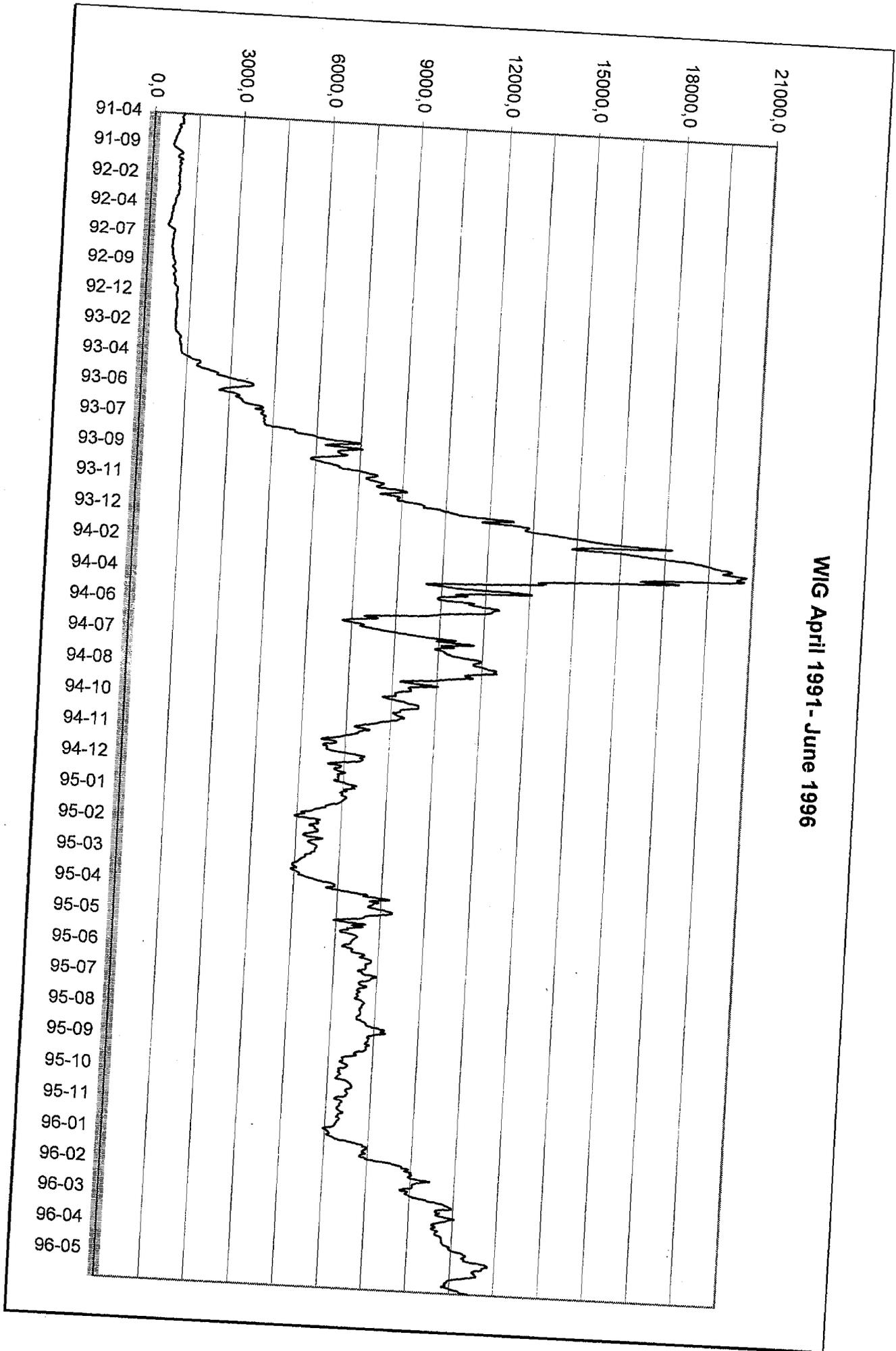
WIG is the main index of the Exchange. It is a “total return” index which takes into account the performance of all companies quoted on the main market of the Exchange. The WIG is weighted according to the market value of the respective companies, restricted to a maximum of 10 percent of the total value of the index. Thus, the impact of any company on the index is limited to its proportion of market capitalization. In the event that a particular company’s participation exceeds 10 percent, its share in the index is reduced at the beginning of the next quarter. Thus, some companies are represented only by a portion of their market capitalization. Additionally, as of April 1995, the participation of individual sectors has been limited to 30 percent of the WIG portfolio, thereby reducing the chances of any one sector skewing the value of the WIG. The base value for the WIG is PLN 1,000 on April 16, 1991. Chart 8 shows WIG performance between April 1991 and June 1996.

The **WIG 20** price index was introduced exactly three years after the first session on the WSE. It is calculated based on a portfolio of 20 companies that are listed on the main market. The companies making up the portfolio are re-evaluated each quarter, and any changes are made at the first session 15 days into the new quarter. Companies are selected each quarter based on the highest turnover value and the highest market capitalization.

Finally, since January 1995, the Warsaw Stock Exchange has calculated an index for the parallel market called **WIRR**. This index follows the same principles as the WIG. In other words, it is also a total-return market capitalization index. Chart 7 shows the performance of the parallel market WIRR.

Chart 7





WIG April 1991 - June 1996

2.4. Information System

The Warsaw Stock Exchange has automated the trading process through the use of an IBM AS/400 computer system. This system has the following features:

- Orders may be entered, updated, or deleted on brokers' office terminals throughout the week;
- On session days, broker specialists may use the Exchange terminals to process orders and establish the day's price;
- Orders are automatically sorted into executed, partially executed and unexecuted;
- An order management module allows the broker to access all orders, both current and historical;
- Confirmation statements can be prepared.

All orders executed during the trading session along with associated contract notes are maintained in the Trading Data Base.

The entire information system is modified frequently as trading and settlement procedures change because of related market developments. The WSE recently undertook a thorough restructuring of its entire computer system after studying the experiences of major Stock Exchanges all over the world. The changes to the WSE are designed to implement continuous trading and introduce new financial instruments such as derivatives. The scheduled two-year process is coordinated by a committee established in March 1995 and comprising representatives of all market intermediaries. All maintenance work and system updates are accomplished by a group of information systems specialists employed by the WSE.

Investors and the general public can access price quotation and company news through the GiGa - Teleservice bulletin (the WSE's on-line automated information system) as well as through the Reuters system (screen pages WSZA - WSZD - shares, WSZE - WSZH - bonds, WSZI - WIG, WSZJ - WSZK - comments, WSZL - WSZZ - financial results), Telerate (pages 39642 and 39644 - shares, 41305-41306 - bonds, 41307-41308 - comments), and Bloomberg. Updated price information is also published in the official Stock Exchange bulletin, "Cedula", and is available in all national newspapers on the day after each session. Investors also can get direct access to results and other information concerning turnover, corporate actions and WSE announcements through their modems.

The following is a brief description of a WSE trading session in a given security:

- Order transfer phase -- between 11 a.m. when WSE stops accepting orders and 11:30 when trading begins. List ("order book") of all limit orders and competitive market (PKC) orders is prepared.

Specialist-broker establishes single-price for security. All non-competitive market (PCR) orders set to WSE are transferred to separate file from which they'll be withdrawn as execution is possible.

- Price-setting phase -- Specialist-broker sets price based on order book prepared by WSE.

- Imbalance determination phase -- Specialist-broker determines size of demand or supply imbalance.

Imbalance resulting from order book is reduced automatically by PCR orders. If total volume of counterbalancing PCR orders isn't sufficient to correct imbalance, specialist-broker either (a) balances market from his/her own inventory or (b) announces offer to market participants. (If specialist-broker balances from inventory or PCR orders sent before session eliminate initial imbalance, balancing phase is unnecessary; next step is crossing phase.)

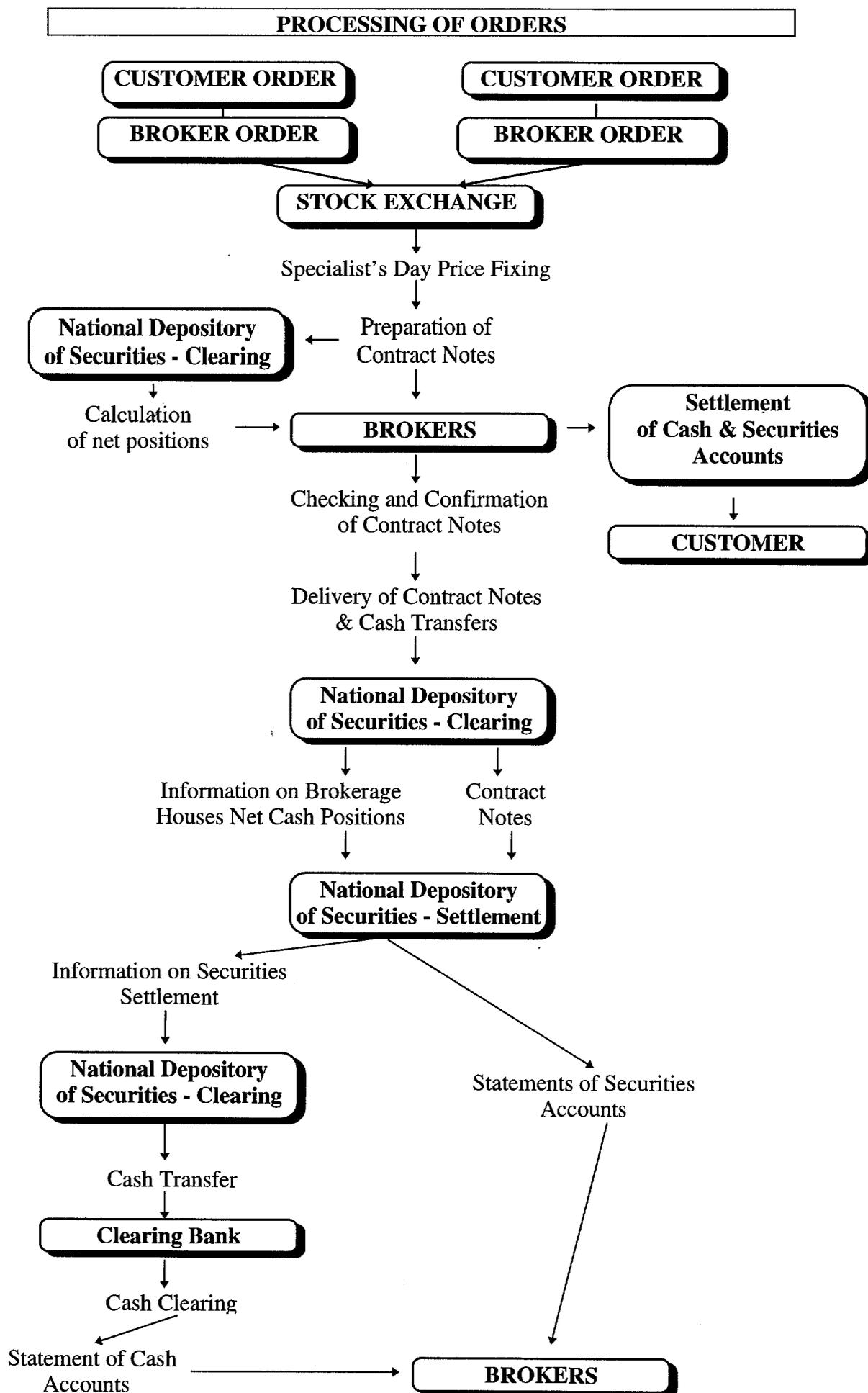
- Balancing phase -- between 11:30 a.m. and 12:15. If not balanced by 12:15, crossing phase not activated.

Specialist-broker invites other brokers to enter orders to eliminate existing imbalance, that is, to fill gap between supply and demand in order book of given security. During this "post-auction" phase, only counter-balancing orders are accepted.

- Crossing phase -- Activated only when market for given security is fully balanced before 12:15. All remaining PCR buy and sell orders revealed. Brokers may send both buy and sell orders regardless of imbalance side.

When trading session closes at 1 p.m., all unexecuted PCR orders and orders sent during session are canceled.

The flow chart on the following page shows how an order is processed.



3. OVER-THE-COUNTER (OTC) MARKET

An Over-the-Counter Market (OTC) is an indispensable part of a mature structure of any capital market.

The Mass Privatization Program currently underway in Poland should further increase activity on the Warsaw Stock Exchange (WSE) in the next few years. The shares of 512 companies are held by 15 National Investment Funds (NIFs), whose own shares will be traded on the WSE. The shares of some of the companies held in the NIFs' portfolios may likewise be listed on the WSE. Others, however, may be unable or unwilling to meet the listing requirements of the WSE. These will find an OTC Market an attractive alternative.

In addition, small- and medium-sized enterprises (SMEs), regional companies and venture capital-type enterprises generally are not well served by the WSE. Listing standards are rigorous, and the Exchange has an implicit bias towards nationally recognized issuer names. That makes raising capital difficult for these companies. The creation of an OTC Market would encourage capital formation for these companies and generally increase liquidity. It also would add diversity to the Polish stock market.

The Association of Brokerage Houses established a Strategic Group to study OTC questions, and most (43) Brokerage Houses subsequently became shareholders in the Central Table of Offers Company (acronym CeTO SA), a joint-stock company with initial capital of PLN 1.25 million. CeTO SA is preparing to open an OTC Market based on an electronic quotations system. It is being assisted by the Barents Group which is contracted through the United States Agency for International Development.

Trading on the new OTC Market, whose communications center will be in Warsaw, is expected to commence in summer 1996.

3.1. Legal Bases

The Ordinance of the Council of the Ministers from June 30, 1995, regulates trading on the Over-the-Counter Market.

Securities admitted to public trading, fully transferable and deposited in the National Depository of Securities can be traded on the OTC. Trading can be organized only by brokerage houses who are members of the National Depository of Securities. The National Depository of Securities will complete settlement of OTC transactions.

The OTC trading system will use:

- A single Central Table of Offers (CTO),
- Continuous information on current offers, bids and executed transactions,
- Registers of admitted securities, market-makers and other participating brokerage houses.

The Ordinance defines the role of the operating entity which has been formed and is CeTO SA. Its primary responsibilities include:

- Preparation of the rules of trading,
- Preparation and operation of:
 1. Information system covering issuers, bids and offers, and executed transactions,
 2. Confirmation system that ensures both parties understand the terms of the trade
- Creation of a separate OTC guarantee fund which will be operated by the National Depository of Securities

The role of a market maker is also defined. A market maker must offer continuously a minimum quantity of a given security for sale or purchase.

3.2. Development of Polish OTC Market

The OTC trading model for Poland will be a hybrid of continuous-auction trading and market-maker systems. The most important element derived from continuous-auction trading will be access to the Central Table of Offers for any customer offer above a specified size.

CeTO SA will collect, process and provide data on (a) buy and sell offers from brokerage houses and market makers and (b) executed transactions. This information will be available continuously via computer to brokers' offices. In addition, information on last sales, best bids and offers will be made public through a public information vendor, TELEGAZETA. This public information will be updated every 15 minutes.

Brokers may access the Central Table of Offers (CTO screen) by modem through ordinary telephone lines or through Telbank or Pol-Pak. Their screen will show offers, last sales and their own confirmed and unconfirmed trades.

Market Participation

The three types of participants in the OTC are market makers, dealers and brokers.

Market makers are OTC members with regulatory responsibility as defined previously. Specifically, they are required to quote markets that are continuous (available all day), two-sided (buy and sell), firm (good as stated). They must quote minimum quantities although the minimum will vary among securities and competitive prices within a range.

Dealers are members who hold a position in a particular security but have no regulatory responsibility. They may sell securities from their Brokerage House account. For example, if a customer's order is too small for placement directly, the dealer can batch the order with other small orders, or sell shares from the Brokerage House account in that security. Dealers also may place their own offers to the CTO screen but only in markets where market-maker participation is inadequate to provide liquidity at competitive prices.

Members who are strictly brokers buy and sell OTC securities on behalf of clients. They will consult the CTO screen to determine who is selling the securities they want to buy or

is buying the securities they want to sell. Then they will telephone the other party (a broker, dealer or market maker) and negotiate the deal. If the buy-sell price spread is too wide and the customer is unwilling to make a trade at the quoted price, the broker can negotiate with the other member or display an offer subject to minimum requirements.

When a transaction has been agreed, both of the members involved must send the information into the central system for automatic comparison. Each side must report the trade for confirmation within five minutes. If a trade is not confirmed, the brokers receive a message to that effect. Confirmed trades will be sent to the National Depository on a diskette (at first) at the end of the business day. Procedures for settlement will be similar to those on the WSE. Monetary settlements will take place at the clearing bank.

3.3. Next Steps

In the second half of 1996 enhancements to the OTC Market's telecommunications systems will be identified and evaluated. Under consideration is the use of a network to be operated by a private, non-profit organization created by the Brokerage Houses. This network will connect all the Brokerage Houses with the CTO and the Warsaw Stock Exchange, and the CTO with the Securities Commission and National Depository of Securities. It will be a "real time" on-line system.

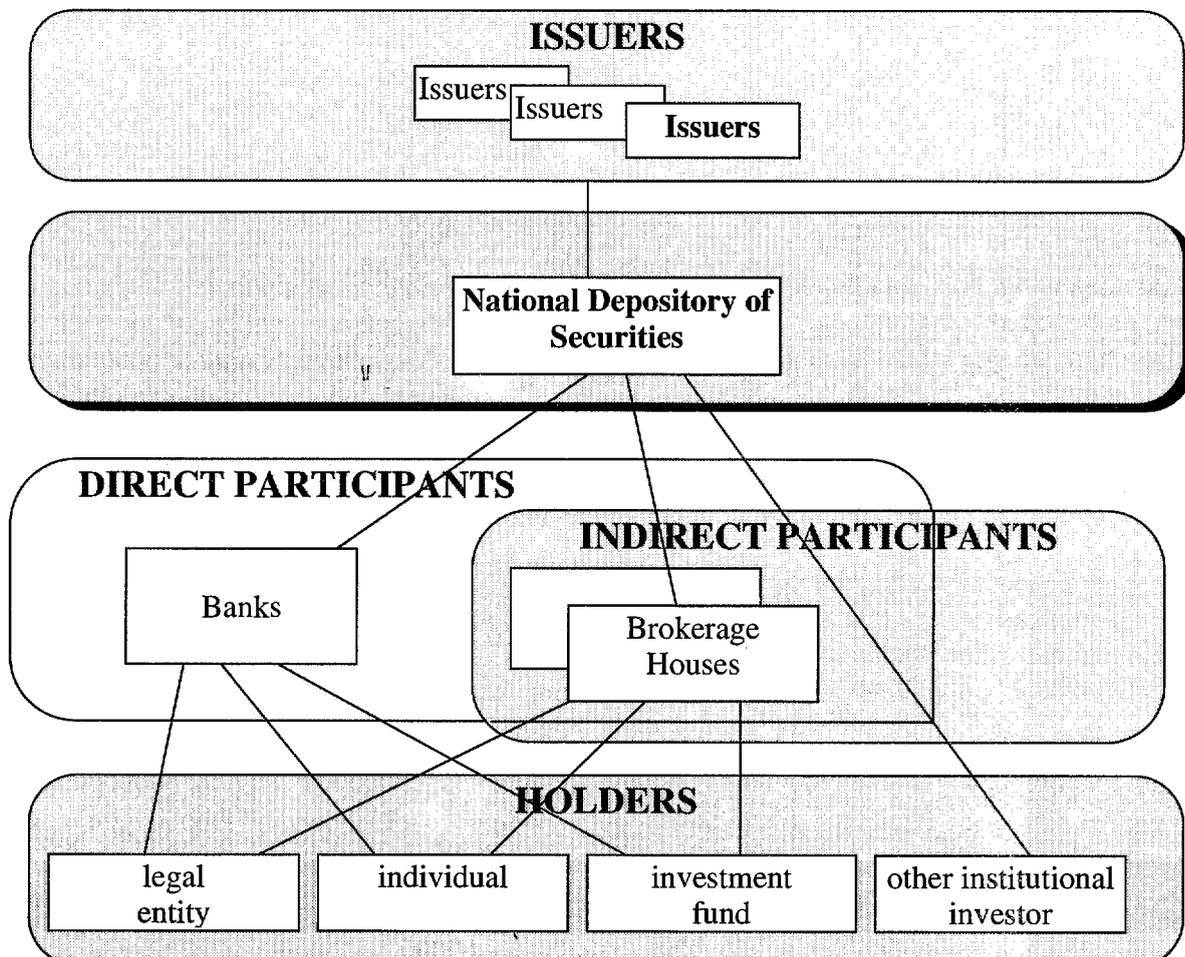
4. NATIONAL DEPOSITORY OF SECURITIES (NDS)

4.1. Legal Status and Organizational Structure of National Depository of Securities

In November 1994, the National Depository of Securities (NDS) was established as a separate legal entity. This was the most important event to take place on the Polish capital market that year. Based on the Act on Public Trading in Securities and Trust Funds (in force since February 14, 1994, by virtue of Art. 71.a § 6a), the National Depository of Securities became a joint-stock-company. The Council of Ministers Ordinance (April 18, 1995) provided for its operations through the Rules of the National Depository of Securities.

The National Depository of Securities was founded by the State Treasury and the Warsaw Stock Exchange as a non-profit joint-stock company. Its share capital stands at PLN 21 million, divided into 21,000 registered shares, each at a par value PLN 1,000. The State Treasury acquired 7,000 shares, and the Warsaw Stock Exchange 14,000. Shareholders do not have rights to dividends. Only Stock Exchanges, brokerage houses, trust funds, the State Treasury, the National Bank of Poland and others banks may own shares in the National Depository of Securities. The most important decision-making and operational-control bodies are the General Meeting, the Supervisory Board and the Management Board.

National Depository of Securities Organizational Structure



The National Depository in Poland works not only as a central depository for all securities admitted to public trading but also as a central clearinghouse.

4.2. Clearing and Settlement System

The National Depository of Securities settles transactions by transferring securities among participant accounts and implementing money transfers among the accounts of its participants in the Clearing Bank. Every member broker of the Exchange must hold a securities account in the National Depository of Securities and a cash account in the Clearing Bank. The Clearing and settlement system operates on a few fundamental rules established by the National Depository. The settlement system operates on delivery-versus-payment (DVP) and a T+3 basis. (The DVP system means that a selling broker does not get paid until he/she furnishes the securities, and a buying broker does not receive the securities until they have been paid for. T+3 means that payment is due 3 days after "T," the day the order is placed.) A T+2 basis is used for State Treasury bond transactions on the block market. The process of preparing accounting, registration and settlement data is computerized.

Transaction settlements are a two-way process. A transaction is settled by a broker with clients on an agreed date. This means that an investor, who holds a securities and money account with a broker, can dispose of money and shares as soon as he/she settles the transaction with the broker, independently of the settlement process between brokers. The National Depository and the Clearing Bank settle their accounts on the third day after the transaction (T+3). Block trades in bonds are settled on T+2. The settlement of securities (traded in paperless form) is conducted by making appropriate changes in the securities registers held by the National Depository and brokerage houses.

Paperless trading means that all securities of a given issue are deposited in the form of global certificates. However, a depository certificate is issued to each shareholder through his/her broker.

The National Depository System, based on paperless trading, eliminates costs associated with the printing, storage and transportation of share certificates as well as the risks of theft and forgery.

A transaction executed on the WSE for an investor is recorded in the investor's account with his/her broker. The investor is informed about all account changes on a printed statement, which is physical proof of share ownership. The National Depository only records changes to the accounts of brokerage houses and banks, thereby ensuring the confidentiality and anonymity of transactions.

4.3 National Depository of Securities' Functions

From its origins in 1991, the NDS has adapted the most up-to-date methods of the well-developed markets. SICOVAM, the Central Depository in France, provided special assistance in developing these methods.

The basic depository responsibilities of the NDS, provided in the Act on Public Trading in Securities and Trust Funds, include:

- Keeping and registering securities admitted to public trading,
- Holding deposit accounts of the entities entitled to hold securities therein,
- Registering transactions in respective deposit accounts between authorized entities,
- Supervising the conformity of the volume of issue with the number of securities in circulation,
- Servicing issuers' obligations to the owners of the securities,
- Issuing deposit receipts,
- Organizing and conducting the settlements of transactions.

An extension of the depository functions is anticipated. It will allow NDS to organize and conduct the settlement of new kinds of transactions such as:

- Derivatives,
- Over-the-Counter Market,
- Universal Share Certificates.

4.4. Guarantee Fund

The National Depository manages a Guarantee Fund for participant liability arising from executed transactions. The Fund's main responsibility is to ensure the safety of exchange trading by guaranteeing its participants' mutual solvency.

The Guarantee Fund is funded by cash contributions from direct participants to a main account and a reserve account. Contributions are made at the time a participant joins the Fund. The contribution to the main account depends on the level of the participant's trading on the Exchange and is subject to periodic updating (now every two weeks). The previous total value of the main account is used to determine the contribution of new participants; that contribution can be no less than 10 percent of what initial participant's paid. A portion of the original funds collected were placed in the reserve account. New participants contribute PLN 1000 to the reserve account.

The income from Fund assets is paid to participants and is directly proportional to payments made to each account. In the case where the Guarantee Fund cannot cover a liability, Fund participants are responsible for making additional (proportional) contributions. The assets of the Depository itself do not back the settlement guarantee.

4.5. NDS' View of Needed Changes

The NDS believes the following legal and operational issues need to be resolved promptly in the near future:

Legal issues

In the case of legal problems, it is extremely important that Polish Securities Law provides for full dematerialization of securities admitted to public trading or that relevant legislation is introduced. Such legislation should also ensure all necessary modifications in existing legal regulation so as to accommodate uncertificated transactions, netting of participant obligations and rapid liquidation of collateral in order to reduce settlement risk.

Such legislation should also entitle the Depository, an institution also acting as a clearinghouse, to specify financial and organizational, or operational requirements for system participants and to assure its right to supervise participants in these areas.

The NDS provides delivery-versus-payment settlement of the locked-in participant transactions received from the Warsaw Stock Exchange. The process includes netting of cash and full control over money settlements at the Clearing Bank. The National Depository plans to analyze the impact of the existing rule that ownership of securities in public trading passes at the moment a transaction is executed (moment T), in light of the DVP principle and the alternative of passing title at settlement.

Operational issues

Necessary new operational plans will include:

- Preparing the clearing system for indirect market participants to ensure participation in the trade comparison system,
- Developing a trade comparison system for other types of markets,
- Expanding the system of security lending and borrowing as a method of expediting the settlement of securities transactions, essential for the planned introduction of continuous trading by the Warsaw Stock Exchange.

National Depository of Securities as Fiscal Agent for Universal Share Certificates in Mass Privatization Program.

Capital market institutions, particularly the National Depository of Securities, will render the services required by the National Investment Funds Program. On November 22, 1995, the distribution of Universal Share Certificates began. In the National Depository, a special department, Fiscal Agent for the Universal Share Certificates, was created.

The Fiscal Agents' main tasks are dematerialization of Universal Share Certificates and the management of the quotas received by the State Treasury from NIF shares (e.g., dividends).

The Universal Share Certificates are issued in bearer, physical form and may be traded as such in a non-regulated market. They also may be traded on the Warsaw Stock Exchange or another regulated non-exchange market after they have been deposited in an investment account at a brokerage house and converted to book-entry form by the Fiscal Agent.

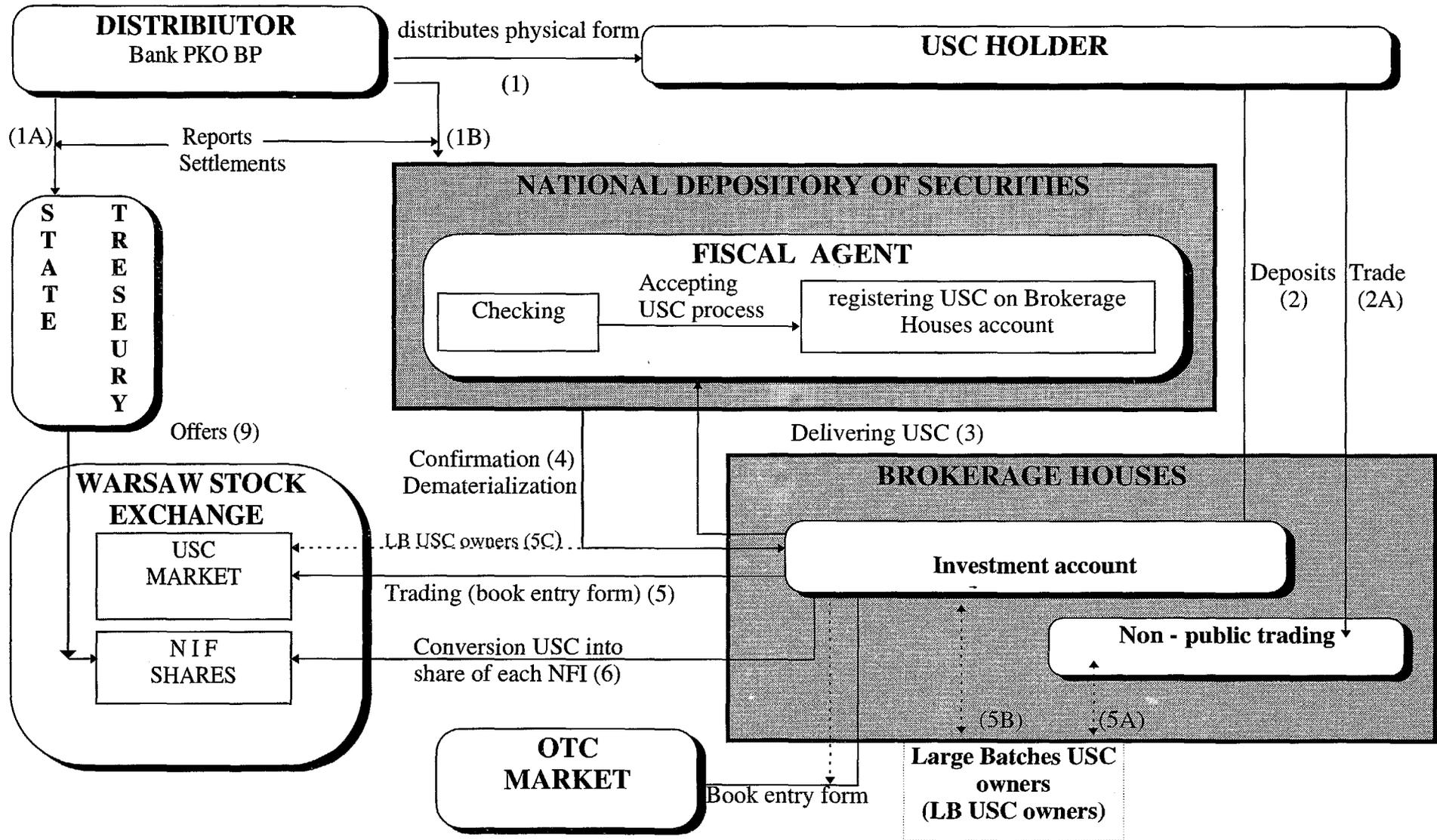
Under the Act on National Investment Funds and their Privatization, they are admitted to public trade and do not require a permit from the Securities Commission.

The exchange of the Certificate must be effected through a brokerage house which will arrange for the Certificate to be deposited at the Fiscal Agent. The Fiscal Agent will check the Certificates and register them on the brokerage houses' accounts. At the same time, the Universal Share Certificates will be registered on the investors' accounts in the brokerage houses.

Under the Act on National Investment Funds and their Privatization, holders are entitled to exchange certificates for an equal number of shares in each of the National Investment Funds existing at the time of issuance. Each Certificate is expected to be exchangeable for a single share in each of the National Investment Funds⁷.

⁷ See Part I, Sec. 6.

UNIVERSAL SHARE CERTIFICATES (USC) PROCESSING



5. MINISTRY OF PRIVATIZATION

5.1. Privatization Process

The ownership transformation process, which started six years ago, is occurring through a decrease in the relative position of State enterprises and the subsequent dynamic development of new private entities. At the beginning (July 1990) 8,441 state-owned companies were registered. The MoP has started the privatization process in 41 percent, or 3,465, of those. In 1995 alone, transformation of ownership was started in 455 enterprises.

A number of privatization methods are available and designed to suit various financial and organizational conditions of the enterprises.

Four basic legal acts regulate these methods:

- Law on State Enterprises (September 1981),
- Law on Privatization of State Enterprises (July 1990),
- Law of Management of Arable Land of the State Treasury Agriculture Properties Agency and the amendments to certain laws,
- Law on the National Investment Funds and their Privatization (April 1993).

Since 1990, two basic privatization paths have predominated: capital privatization and privatization through liquidation (direct privatization). The choice of a method depends on several factors, including the size of the enterprise in terms of annual turnover, projected financial and production indicators, interest expressed in a given enterprise by Polish and foreign investors and the number of employees.

Capital Privatization

Capital privatization is the implementation of Government policy directed at transforming the Polish economy from one of only government ownership to one of private ownership of business entities. Through its privatization actions, the Government has spun off companies which today are the main source of companies listed on the Warsaw Stock Exchange. This method of privatization has been the only effective method for matching Polish companies with interested foreign investors. Capital privatization offers an opportunity for basically sound enterprises to achieve private ownership through stock holding by individual investors. Revenues to the State Treasury as a result of capital privatization totaled PLN 1,714 million in 1995.

Privatization through Liquidation

Privatization through liquidation means closing the state enterprise and leasing or selling the enterprises assets (land, buildings, equipment). This method is generally applied to small- and medium-sized enterprises which are usually in relatively good financial condition and for which prospects of finding private capital exist. The liquidated enterprise can be sold, incorporated into a company or leased to a company established by the majority of the employees. Unfortunately, hundreds of companies leased by employees have weak capital structures and significant debts, causing additional economic problems.

Since July 1991, the so-called "fast track" privatization program of small- and medium-sized enterprises through public tender has been implemented. This method accelerates and simplifies the privatization process.

The complete transformation of ownership can be split into the four categories, companies:

- Sold via traditional capital privatization techniques, purchased by institutional investors or listing on the Warsaw Stock Exchange -- 160 completed,
- Participating in the Mass Privatization Program -- 512,
- Liquidated and taken over by new employee-created companies -- 1,054 completed and 95 in process,
- Bankrupt and their assets sold -- 395 completed and 963 in process.

The above MoP figures are as of March 1996.

The Ministry of Privatization pursued the sector approach as another way to prepare enterprises for privatization. The basic idea was to develop an overall policy for whole sectors of the economy and to determine an overall direction for their development and privatization. The economy was divided into 34 sectors based on industry type and product categories. Then these sectors were assigned to international consulting firms for analyses for each and recommendations on how the companies in each sector can be privatized or restructured. While most sector studies are nearly completed, the consulting companies have been less successful in identifying privatization methods or possible investors.

Statistics on Privatization through the Ministry of Privatization 1990-1995

Period	Total	Privatization through Liquidation						Capital Privatization and Mass Privatization Program Joint-Stock Companies Owned by State Treasury Only			
		Taken Over or Leased by Employees			Liquidation Because of Poor Company Condition			Capital Privatization			MPP
		Started	Done	%	Started	Done	%	Started	Done	%	
1991	1249	449	182	41	540	19	4	260	27	10	-
1992	2056	719	475	66	857	86	10	480	51	11	-
1993	2526	917	707	77	1082	186	17	527	99	19	-
1994	3010	1042	945	90	1245	303	24	723	134	19	413
1995	3465	1149	1054	82	1358	395	29	958	160	17	457

Source: Ministry of Privatization March 1996

The process of economic transformation over the past three years has resulted in a vast change in the general public's attitudes toward private ownership. Privatization has offered many individuals the biggest financial opportunity of their lives. This psychological effect is also a very important aspect of privatization.

From the capital markets' perspective, it's important to remember that the Ministry of Privatization controls both the Warsaw Stock Exchange and National Depository of Securities (NDS). The Ministry owns 98 percent of the shares of the WSE. One-third of the shares of the NDS are owned by the State Treasury and two-thirds by the WSE. The idea of privatizing both the WSE and NDS has been discussed with increasing frequency by Brokerages Houses, banks and others. However, it has been one of the best performing State-owned enterprises financially. The Ministry is only willing to sell the WSE at a fair market value which is more than those seeking its privatization can afford. Because WSE Supervisory Board of 14 members only includes three representatives of Brokerage Houses, they have not been able to change the Ministry's position.

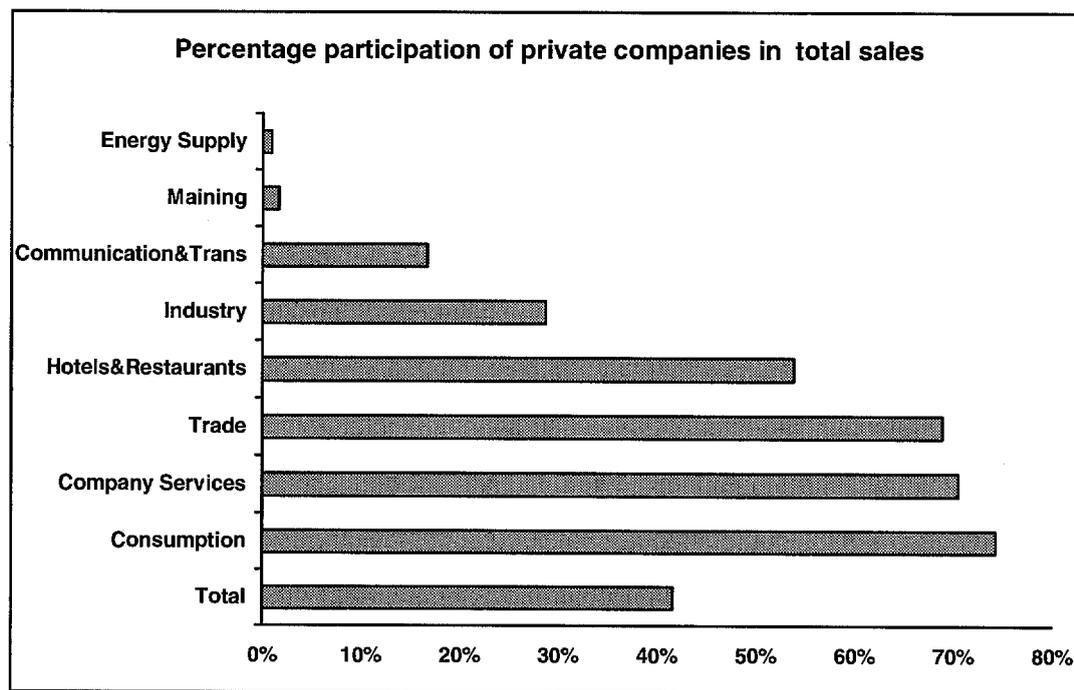
New issues in Poland are dominated by the privatized companies. It puts the Ministry of Privatization (MoP) in a leading position among the most important institutions in terms of creation of capital markets. In the last year the MoP has sold eight companies in public offerings (seven in 1994).

5.2. Impact of Industry Privatization on Polish Economy

According to the Central Statistical Office (GUS), by year-end 1995 the privatization process had begun on 55 percent of the State properties supervised by various ministries or provincial governments, or owned by the State Agency for Ownership of Agriculture Land. At year-end 1995, 1,300,000 employees (15 percent of all employed persons) are working in companies that are being privatized. Reprivatization (disposition of companies taken over by the State from private owners) has not been successful to date.

In 1995, private companies in Poland contributed to 41.5 percent (35.2 percent in 1994) of total sales. The breakdown of sales can be seen in the following chart.

Chart 9



The impact of the privatization process on the Polish economy can be reflected in the increase in GNP: 1992 -- 2.5 percent, 1993 -- 3.8 percent, 1994 -- 4.9 percent, and 1995 -- 7.0 percent.

Despite the 1995 implementation of the Mass Privatization Program, an estimated 3,610 state-owned enterprises in Poland with a total book value of PLN 75 billion (about \$30 billion) still exist in 1996.

The Government intends to intensify the privatization process in 1996. Capital privatization will continue, mainly in the following sectors: chemical, pharmaceutical, iron and steel metallurgy, ball bearings, non-ferrous metal, automobile, construction and building materials, furniture, clothing, beer, tobacco, meat, oils and fats, sugar, cereal and finance. The Polish government predicts an 1996 income of PLN 2.6 billion (\$1 billion) from privatization.

It is also worth noting that environmental liability and protection issues have been emphasized strongly in the work of the Ministry. A group of consultants is focusing on pro-ecological investments in restructured companies.

6. MASS PRIVATIZATION PROGRAM (MPP)

The experience of the Ministry of Privatization on privatization through capital methods (sale through public offering or to individual investors) shows that these are appropriate for the privatization of large enterprises and are attractive in economic terms. But, on a national scale and considering Polish industry as a whole, the capital privatization process is slow and expensive. The object of the Mass Privatization Program (MPP) is to create another, though not exclusive, mechanism of privatization which will accelerate and broaden its scope while also lowering the cost of ownership changes.

The Mass Privatization Program in Poland is considered to be unique worldwide. To transfer the rights of privatized assets to citizens, an intermediary was introduced. That intermediary is a National Investment Fund. Shares of privatized enterprises, instead of being allocated directly among citizens, were divided among 15 National Investment Funds (usually called NIFs). The NIFs serve as brokers, introducing a property and ownership supervision program for the enterprises.

The MPP proposed that the establishment of NIFs should be seen as the private property of Polish citizens. They were designed to help restructure and increase the value of the assets of the former state enterprises transformed into independent companies. This allows for the eventual sale of company shares at a higher price and enables shareholders to profit in the future. The NIFs are managed by professional fund managers.

6.1. Act on National Investment Funds and Their Privatization

The existing legal infrastructure is generally considered to be insufficient for the much-needed acceleration of the privatization process. The Act on National Investment Funds and Their Privatization consistently and comprehensively strives to address the problems. The full implementation of MPP should accelerate effectively the process of privatization of the national economy and the improvement of its management, while at the same time achieving these goals in a manner compatible with the general public's sense of social justice.

The Act allows for the creation of National Investment Funds (NIFs). The NIFs are constituted as joint-stock companies subject to the Commercial Code. All dealings between the Funds and the companies or Management Firms of the Funds are subject to Polish law. The Funds have the character of Polish national institutions. The State Treasury initially allows the Funds' shares (called Universal Share Certificates) to be available exclusively to Polish citizens on an equal basis.

Each Polish adult (adults means any Pole reaching age 18 no later than December 31, 1994) can share in the privatization process by purchasing, for PLN 20 (about \$8), a Universal Share Certificate, a bearer, physical form which represents, and later is convertible into, shares in the NIFs.

The law also provides for the creation of a separate class of bearer share certificate, called the "Compensation Share Certificate", which will be available free of charge to certain pensioners and civil servants who are owed money by the government as a result of a constitutional court ruling. These certificates will represent special funds, created for the purpose of restitution, separate from the funds mentioned above. (See Part I, Sec. 5.1.)

In due course, any investor, including foreign investors, may invest directly in any of the NIFs and in any of the companies participating in the MPP. Joint ventures may be formed, and shares or even entire companies in the NIF portfolios may be sold to investors.

Companies in the NIFs are expected to be listed on a public market (e.g., the parallel market of the Warsaw Stock Exchange or the Over-the-Counter Market when it is created). Equity in the NIFs, initially represented in the form of Universal Share Certificates, will be convertible into book-entry⁸ shares of the NIFs which will then be traded on the WSE. (See Part I, Sec. 1.4.)

The MPP will have a significant impact on Poland's capital markets by creating new possibilities and circumstances for participation in the market. First and foremost, the program will create a vast new pool of securities available (in material form, at the very least) to millions of people. The quantity of transactions and the needs of the market will change dramatically.

6.2. Structure of National Investment Funds

Each of the 15 National Investment Funds is controlled by a Supervisory Board, charged with representing the interests of its shareholders. These boards are comprised of suitably qualified individuals nominated and appointed by a specially convened selection Commission. At least two-thirds of the members of the boards (including the chairman) have to be Polish citizens.

The Fund management team of each NIF reports to the Supervisory Board under a management contract and a performance contract which provide financial incentives to increase the long-term value of the Fund. Each NIF is expected to remain in existence for at least 10 years.

A total of 512 state-owned companies were selected for participation in the MPP. The Minister of Privatization evenly distributed 60 percent of the shares of each of these enterprises (now joint-stock companies) among the Funds. Up to 15 percent of the shares are being distributed free-of-charge to employees of companies in the program. The remaining 25 percent of shares are retained by the State Treasury to generate dividend income for the budget and for later sale.

⁸The US (American) usage of "Book-Entry" is used throughout the report to refer to the condition of a share being issued in the form of a record-keeping entry without physically issuing or producing a printed share certificate, said usage equal to the European usage of "Dematerialized" share.

At the beginning of the program, each company had the same ownership structure:

- 33 percent of shares held by the NIF primarily responsible for its restructuring (the "lead" NIF),
- 27 percent of shares distributed equally to all other NIFs,
- 25 percent of shares retained by the State Treasury,
- 15 percent of shares distributed free-of-charge to the employees of the MPP companies.

Each NIF is managed by a firm or consortium selected by public tender from among reputable investment banks and fund management organizations from Poland and abroad. These fund managers are responsible for improving the management of the companies, by strengthening their market positions, introducing new technology and providing access to growth capital.

Fourteen NIFs signed management contracts with investment advisory companies. Most of the management firms contractual remuneration depends on the financial results of the companies whose shares they manage. As a result, the advisory company will have a significant economic incentive to maximize the financial results of these companies.

Information on the selected NIF managers is shown on a table on the following page.

<i>Working Name of NIF</i>	<i>Fund Manager</i>	<i>Shareholders of Management Company</i>	<i>Shares (%)</i>
NIF I	BRE/IB Austria Ltd.	<ul style="list-style-type: none"> • Bank Rozwoju Eksportu SA • IB Austria 	<ul style="list-style-type: none"> • 51 • 49
NIF II	Hevelius Management Ltd.	<ul style="list-style-type: none"> • UNP International Holding Ltd. • Bank Gdański SA • Murray Johnstone Poland Ltd. 	<ul style="list-style-type: none"> • 65 • 25 • 10
NIF III	Trinity Management Ltd.	<ul style="list-style-type: none"> • Barclays de Zoete Wedd International Holdings • Bank Polska Kasa Opieki SA • Company Assistance Ltd. 	<ul style="list-style-type: none"> • 33.3 • 33.3 • 33.3
NIF IV	Raiffeisen Atkins-Fund Management SA	<ul style="list-style-type: none"> • Raiffeisen Investment AG • Raiffeisen Centrobank SA • W.S. Atkins Limited • Idea Ltd. • WIL Consulting House • Adin Ltd. 	<ul style="list-style-type: none"> • 26 • 25 • 25 • 9.5 • 9.5 • 5
NIF V	Polskie Towarzystwo Prywatyzacyjne - Kleinwort Benson Ltd.	<ul style="list-style-type: none"> • Kleinwort Benson Management Oversees • Polski Bank Rozwoju SA 	<ul style="list-style-type: none"> • 51 • 49
NIF VI	Chase Gemina Polska Ltd.	<ul style="list-style-type: none"> • Chase Gemina Italia • Wielkopolski Bank Kredytowy SA • Nicom Consulting Ltd. 	<ul style="list-style-type: none"> • 51 • 29 • 20
NIF VII	LG Fund Management Co. AG	<ul style="list-style-type: none"> • GICC Capital Corporation • Lazard Freres et Cie • Bank Gospodarstwa Krajowego 	<ul style="list-style-type: none"> • 33.3 • 33.3 • 33.3
NIF VIII	KP Konsorcjum	<ul style="list-style-type: none"> • KP International Ltd. • Bank Handlowy SA • PaineWebber Inc. 	<ul style="list-style-type: none"> • 60 • 20 • 20
NIF IX	To be managed by its Supervisory Board		
NIF X	Fidea Management Ltd.	<ul style="list-style-type: none"> • Bank Arjil • Agencja Rozwoju Przemysłu • Warszawska Grupa Konsultingowa • Bank Inicjatyw Społeczno-Ekonomicznych 	<ul style="list-style-type: none"> • 60 • 18 • 18 • 4
NIF XI	KNK/New England Investment Companies Ltd. (N.B. - In April 1996 NIF Supervisory Board denounced contract of manager.)	<ul style="list-style-type: none"> • New England Investment • KNK Finance & Investment Ltd. • Wasserstein Perella Emerging Markets 	<ul style="list-style-type: none"> • 20 • 50 • 30
NIF XII	Pallas Stern PBI Euro fund Management Polska Ltd.	<ul style="list-style-type: none"> • Pallas Stern International BV • Polski Bank Inwestycyjny 	<ul style="list-style-type: none"> • 80 • 20
NIF XIII	Yamaichi Regent Special Projects Ltd.	<ul style="list-style-type: none"> • Yamaichi International • Regent Pacific Group • Consulting ABC 	<ul style="list-style-type: none"> • 54 • 36 • 10
NIF XIV	International Westfund Holdings	<ul style="list-style-type: none"> • Bank Zachodni • Central Europe Trust • Charterhouse Development Capital • Credit Commercial de France 	<ul style="list-style-type: none"> • 33.7 • 33 • 22.2 • 11.1
NIF XV	Creditanstalt SCG Investment Fund Management SA	<ul style="list-style-type: none"> • Creditanstalt Investment Bank • SCG St. Gallen Investment Holding AG • Mr. H. Pecina • Mr. W. Behrendt 	<ul style="list-style-type: none"> • 49.9 • 49.9 • 0.1 • 0.1

7. MINISTRY OF FINANCE

In parallel with the transformation of the national economy and creation of a new State institutional framework, the Ministry of Finance has started to create new capital market instruments more in keeping with the nature of a government functioning in a market economy. Rather than financing debt through central bank credits (or running the royal mint), the Government has begun to turn to various treasury instruments. The development of a treasury instrument marketplace is one of the biggest successes of the new system.

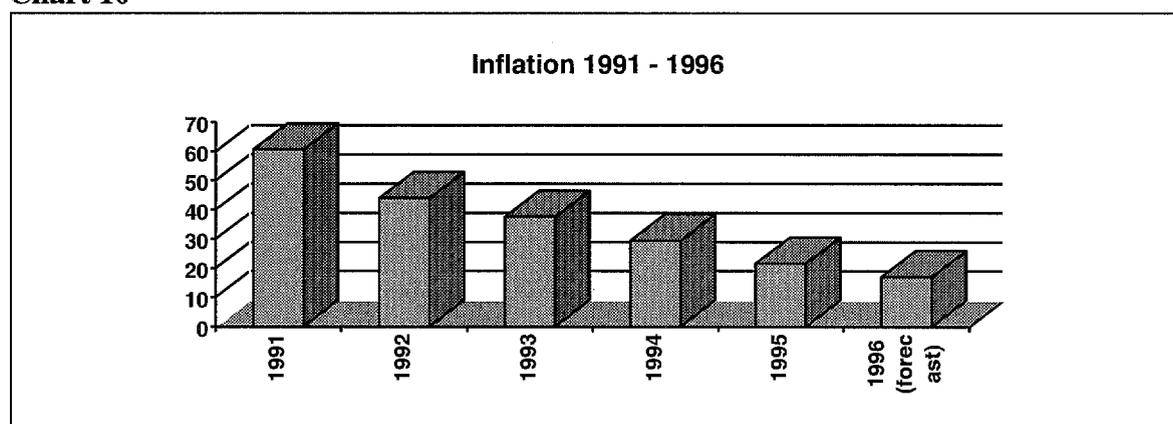
Highlights of 1995 associated with the Ministry of Finance and directly influencing the Polish capital markets were:

- The turnover tax was suspended for the period February 27 to June 30, 1995, then in June the suspension was extended to year end.
- For the first time, the Minister of Finance established an initial price of a bond higher than nominal price. The price of Three-Year Floating-Rate State-Borrowing (TZ0298) was 101 percent of nominal price.
- On June 27, 1995, Poland returned to the international capital markets. The first Polish Bonds denominated in US dollars were offered for sale.
- Inflation was reduced to 21.6 percent.
- On December 10, 1995, the Ministry suspended the turnover tax to the end of 1996.

7.1. Inflation

Inflation for December 1996 is forecast at 17 percent compared with 21.6 percent in December 1995, 29.5 percent in December 1994 and 37.6 percent in December 1993.

Chart 10

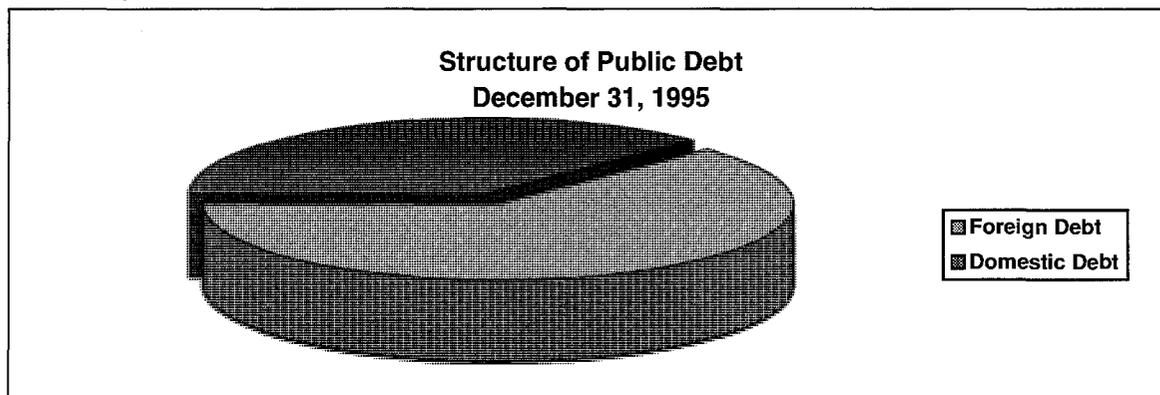


Source: Ministry of Finance

7.2. Public Debt

On December 31, 1995, public debt was PLN 161,126.7 million, including PLN 100,836.4 million (62.6 percent) of foreign debt and PLN 60,290.3 million (37.4 percent) of domestic debt.

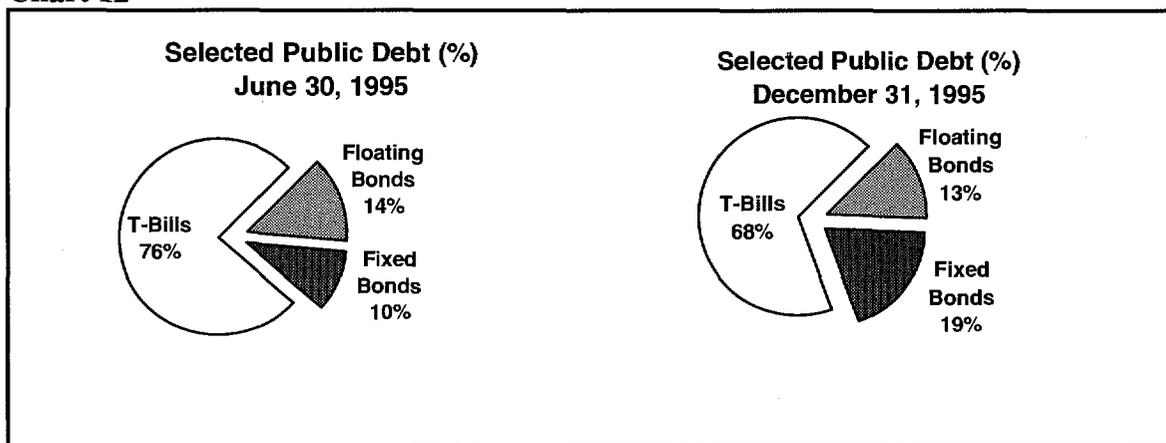
Chart 11



Source: Ministry of Finance

Public debt (excluding accrued interest and discount) increased by 12.8 percent between June 30, 1995, and December 31, 1995 (20.2 percent in the second half of 1994). Similar to the previous period, fixed-rate bonds recorded the highest rate of growth. The value of the five-year issues increased by 53.8 percent while two-year bonds were up by 34.4 percent. Consequently, the share of fixed-rate instruments increased to 12.8 percent of the total. Floating-rate instruments also gained market share (19.1 percent) and a significant drop in T-Bills (68.1 percent of all issues outstanding). Floating-rate ten-year bonds were introduced and accounted for 1.4 percent of the total at year end.

Chart 12



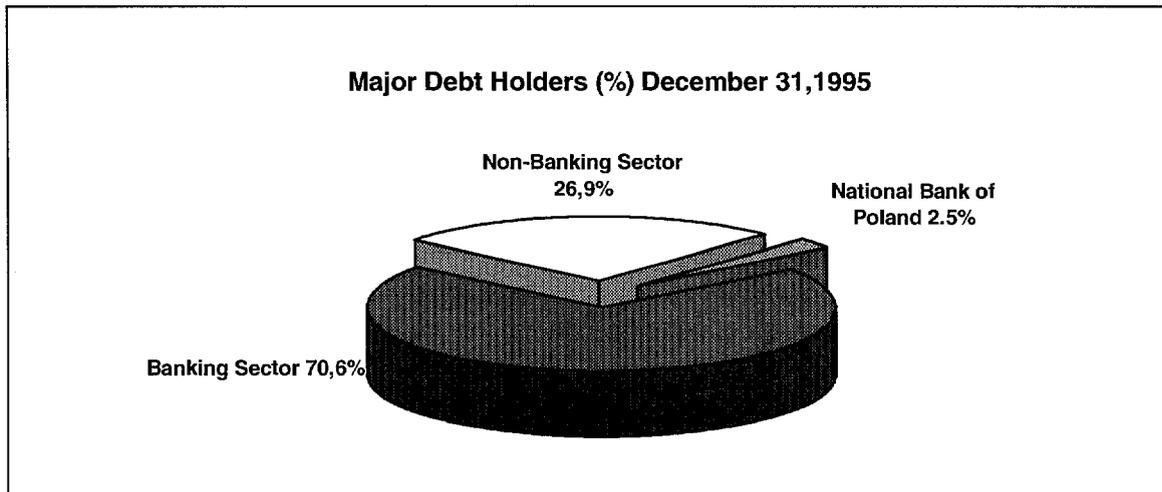
Source: Ministry of Finance

7.3. Debt-Holders

The combined share of the banking sector in public debt holdings decreased to 73.1 percent at December 31, 1995; it had been 82.4 percent in June 30, 1995. The NBP drastically scaled back monetization of the budget deficit. It held only 0.1 percent of outstanding T-bills in December 1995, compared with 11.3 percent six months earlier. The

share of the non-banking sector significantly increased to 26.9 percent, compared with 17.6 percent in the first half of 1995.

Chart 13



Source: Ministry of Finance

7.4. Treasury Securities

Poland's Treasury Securities can be divided into two main groups:

- Active Treasury Securities which finance the annual State budget deficit, repayment of long-term loans and cover negative balance of foreign financing (that is, financing budget borrowing requirements),
- Passive Treasury Securities used to fulfill existing liabilities of the State budget (bonds denominated in US dollars and Conversion Bond Issues), or those which are used in contracting new State budget liabilities as securities issuances carried out of financial markets (Restructuring Bonds issued to enlarge the banks' own funds and reserves as well as bonds for the NBP to realize the agreement with London Club bank creditors).

Treasury Securities issued to foreign markets can be divided into two groups:

- Bonds exchanged for Poland's outstanding indebtedness in the face of the commercial banks associated in London Club. The bonds were issued within the limits of the agreement to reduce and restructure Poland's foreign debt. As a result of the agreement, one part of the debt was redeemed in cash, and the remainder was exchanged into six types of bonds. Those bonds are known as Polish Brady Bonds.
- Eurobonds with a fixed interest rate of 7.75 percent per year. Eurobonds were placed on the European and American markets as well as on the Asiatic markets. The maturity date of the bonds is July 13, 2000.

The Ministry of Finance issued following bonds and bills:

- Bonds (active)
 1. One-Year State-Borrowing
 2. One-Year Index-Linked State-Borrowing
 3. Three-Year State-Borrowing
 4. Three-Year Floating-Rate State-Borrowing
 5. Fixed-Rate State-Borrowing
 6. Ten-Year Floating-Rate State-Borrowing

- Bills
 1. Materialized
 2. Dematerialized (from 1995)

- Bonds (passive)
 1. Domestic State-Borrowing 60 percent
 2. Redeemable in Shares of Privatized Enterprises
 3. Denominated in US dollars
 4. Restructuring (bonds issued to increase the banks' own funds and reserves)
 5. Convertible (bonds issued to cover the State budget debt at the NBP)
 6. Bonds to finance implementation of agreement between NBP and commercial banks

- Bonds issued for international markets
 1. 7.75 percent Eurobond
 2. Collateralized Discount Bond
 3. Collateralized Par Bond
 4. RSTA Bond
 5. Past-Due Interest Bond
 6. Debt Conversion Bond
 7. New Money Bond

List of Treasury Bonds listed on Warsaw Stock Exchange in 1995

<i>Name of Bond</i>	<i>Code</i>	<i>Redemption date</i>
1. One-Year State-Borrowing	PPJ8	02.03.95
2. One-Year Index-Linked State-Borrowing 06/95	IRPP0695	02.06.96
3. One-Year Index-Linked State-Borrowing 09/95	IRPP0995	02.09.95
4. One-Year Index-Linked State-Borrowing 03/96	IRPP0396	02.03.96
5. One-Year Index-Linked State-Borrowing 06/96	IRPP0696	02.06.96
6. One-Year Index-Linked State-Borrowing 09/96	IRPP0996	02.09.96
7. One-Year Index-Linked State-Borrowing 12/96	IRPP1296	02.12.96
8. Three-Year State-Borrowing Series I 08/95	PPT1	04.08.95
9. Three-Year State-Borrowing Series II 11/95	PPT2	03.11.95
10. Three-Year State-Borrowing Series III 02/96	PPT3	04.02.96
11. Three-Year State-Borrowing Series IV 05/96	PPT4	05.05.96
12. Three-Year State-Borrowing Series V 08/96	PPT5	05.08.96
13. Three-Year State-Borrowing Series VI 11/96	PPT6	05.11.96
14. Three-Year State-Borrowing Series VII 02/97	PPT7	05.02.97
15. Three-Year State-Borrowing Series VIII 05/97	PPT8	05.05.97
16. Three-Year Floating-Rate State-Borrowing 08/97	TZ0897	09.08.97
17. Three-Year Floating-Rate State-Borrowing 11/97	TZ1197	09.11.97
18. Three-Year Floating-Rate State-Borrowing 02/98	TZ0298	09.02.98
19. Three-Year Floating-Rate State-Borrowing 05/98	TZ0598	09.05.98
20. Three-Year Floating-Rate State-Borrowing 05/98	TZ0898	09.08.98
21. Three-Year Floating-Rate State-Borrowing 11/98	TZ1198	09.11.98
22. Fixed-Rate State-Borrowing 06/96	PPOS0696	12.06.96
23. Fixed-Rate State-Borrowing 10/96	PPOS1096	12.10.96
24. Fixed-Rate State-Borrowing 02/97	PPOS0297	12.02.97
25. Fixed-Rate State-Borrowing 06/97	PPOS0697	12.06.97
26. Fixed-Rate State-Borrowing 07/97	PPOS0797	12.07.97
27. Fixed-Rate State-Borrowing 08/97	PPOS0897	12.08.97
28. Fixed-Rate State-Borrowing 10/97	PPOS1097	12.10.97
29. Fixed-Rate State-Borrowing 02/98	PPOS0298	12.02.98
30. Fixed-Rate State-Borrowing 06/99	PPOS0699	12.06.99
31. Fixed-Rate State-Borrowing 10/99	PPOS1099	12.10.99
32. Fixed-Rate State-Borrowing 02/00	PPOS0200	12.02.00
33. Fixed-Rate State-Borrowing 06/00	PPOS0600	12.06.00
34. Fixed-Rate State-Borrowing 07/00	PPOS0700	12.07.00
35. Fixed-Rate State-Borrowing 08/00	PPOS0800	12.08.00
36. Fixed-Rate State-Borrowing 10/00	PPOS1000	12.10.00
37. Fixed-Rate State-Borrowing 02/01	PPOS0201	12.02.01
38. Ten-Year Floating-Rate State-Borrowing	DZ1205	14.12.05

8. BANKING SECTOR AND NATIONAL BANK OF POLAND (NBP)

8.1. Legal Framework and Banking Regulation

Reform of the Polish banking system started in 1989 with the enactment of comprehensive banking regulations through two major legislative acts: the Law of the Narodowy Bank Polski (NBP) and the Banking Law. Both were implemented in January 1989. They introduced a two-tier banking system and empowered the President of the NBP to regulate banking institutions and markets.

The Banking Law incorporates articles regulating the most important banking operations:

- Defines banking operations, products and services in general,
- Determines banks' responsibilities as public trust institutions toward their customers, depositors and borrowers,
- Determines in part the relationship between commercial banks and the central bank,
- Determines the banks' solvency norms,
- Identifies a framework for bank bankruptcy proceedings and establishes reorganization and liquidation rules,
- Deals with banks secrecy obligations,
- Establishes general reporting requirements for banks,
- Empowers the President of the NBP to license banking activities,
- Empowers the President of the NBP to nominate an administrator and call for the preparation of a rehabilitation program for a bank in distress.

Basic amendments to the Banking Law have strengthened the NBP's supervisory powers. The General Inspectorate of Banking Supervision forms a part of the NBP structure. The major task of Banking Supervision is to enforce the banking regulations and to examine banks' compliance with relevant laws and regulations, in accordance with European Union's Directives and Regulations.

8.2. Banking Sector Development

Until the end of 1988, the banking system in Poland could best be described as a "monopoly bank". Nearly 90 percent of available loans for businesses were granted by the National Bank of Poland, which at the same time functioned as a central bank. Five other specialized banks served specific functions (*e.g.*, trade financing). The main purpose of the banking system was to supply the Polish economy with money in a purely administrative way.

Reform of the Polish banking system started in 1989 after the enactment of the December 1988 Banking Law introduced a two-tier structure to the banking system. The structure consists of a central bank at the core and commercial banks. The transformation of the Polish economy into a market-driven system, initiated in 1990, heightened the need for

fully-operational banking institutions, which had been liquidated or twisted out of recognizable form under the centrally-planned system of the former communist government.

As Poland becomes a free-market economy, the functions and role of the NBP have become more or less similar to the functions and role of a central bank in any developed market economy. Under the Banking Law, regional NBP branches were transformed into state commercial banks. Nine new banks took over employees, clients, accounts, dues, and liabilities of the old NBP branches. These banks have their headquarters in the larger Polish cities:

Warszawa	- Powszechny Bank Kredytowy SA,
Kraków	- Bank Przemysłowo Handlowy SA,
Łódź	- Powszechny Bank Gospodarczy SA,
Katowice	- Bank Śląski SA,
Wrocław	- Bank Zachodni SA,
Lublin	- Bank Depozytowo-Kredytowy SA,
Poznań	- Wielkopolski Bank Kredytowy SA,
Gdańsk	- Bank Gdański SA,
Szczecin	- Pomorski Bank Kredytowy SA.

Each of these banks has a network of 30 to 50 branches located within its region.

Subsequently, these and other regional banks opened new branches outside their main service areas. The result was a growth of banking offices and diversification of banking facilities. In the beginning of the 1990s, 15 commercial banks operated in Poland, nine regional state banks and six specialized state banks. Licenses for conducting banking activities have been issued to more than 90 institutions.

The program of economic transformation has included the transformation of nine state banks, which have evolved from the division of regional NBP branches into private entities, and the present establishment of four into private financial institutions:

- Wielkopolski Bank Kredytowy SA,
- Bank Śląski SA,
- Bank Przemysłowo Handlowy SA,
- Bank Gdański SA.

Besides banks capitalized through Polish sources, the NBP and the Ministry of Finance have issued licenses to 14 representative offices of foreign banks or joint ventures. The dedicated representative offices include:

- American Express (Poland) Ltd.,
- ING Bank Warsaw,
- Societe Generale.

Licenses also were issued to establish joint venture banks with foreign capital participation:

- Hypo-Bank Polska SA,
- American Bank in Poland Inc.,

- Reiffeisen Centrobank SA,
- Creditanstalt Bank SA,
- International Bank in Poland SA,
- Polsko-Amerykanski Bank Hipoteczny SA,
- Polsko-Kanadyjski Bank Św. Stanisława SA,
- Citibank (Poland) SA,
- Deutsche Bank Polska SA,
- Westdeutsche Landesbank (Polska) SA,
- BNP - Dresdner Bank (Polska) SA.

Quantitative service statistics such as those typically published for mature economies are not available. Polish banks do not monitor the degree of credit commitment to particular sectors of the economy, nor do they assess the total amount of loans given to inter-linked clients, and/or the credit worthiness of other banks in which they place deposits.

Credit risk is the dominant issue for Polish banks. Under the guidance of the Ministry of Finance, the banks are trying to solve this problem by categorizing non-performing loans into those which are recoverable and those which should be written off. In the latter case, banks will foreclose on the secured assets and liquidate the debtor enterprise through a sale of assets in order to recover a portion of the loan outstanding. Banks are also considering converting some of the problem loans in their portfolios into capital shares in the debtor companies ("debt/equity swaps"). For debtors that are in difficulty but have reasonable prospects for the future, banks are examining other solutions such as collateralization of additional assets.

Amendments to the 1989 legislation of the Banking Law and the Law of the National Bank of Poland were adopted in December 1992. These enable new legislation such as new banking law and laws on the state monetary system, state central bank, loan guarantees and bank deposit insurance. Regarding deposit insurance, the present deposit-holders' protection system is inadequate, totally covering only three state-owned banks set up before 1989. The remainder, about 80 banks, are in the Bank Guarantee Fund which guarantees deposits only to ECU 3000.

A major step forward was the implementation of the Central Clearing House (Polish acronym of "KIR") which commenced operations in May 1993. Nearly all large banks participate in its operation of an inter-bank money market. Membership in KIR is intended to provide a capability for over-night deposit and the ability to compare bank positions on a daily basis. KIR shortens the entire inter-bank settlement process, accelerating the turnover of capital in the banking system.

The new inter-bank settlement principles were introduced in phases with June 30, 1994, as the deadline for closing down the old system. The new system (Sybir) allows banks to perform inter-bank settlements in real time. This means the bank settlement cycle was shortened to two days (it had been five to eight days). In 1994 gross transactions in the KIR had increased significantly, from about PLN 16 billion in January to more than PLN 25 billion in December.

Through a second system, Elikisir, introduced in April 1994, the customer account settlement cycle was shortened to one day. By year-end 1995 most banks were using or implementing Elikisir.

8.3. Major Problems in Polish Banking Sector

During the recession, the hard budgetary constraints on enterprises caused many to lose liquidity. Many started to cut down on employees and to sell useless assets. A few state enterprises went into bankruptcy; many more were disbanded, easing them into privatization by creating much smaller and far more effective firms. The banks have been active in restructuring these enterprises, evaluating their programs of financial reconstruction, advising sale of non-productive assets, internal reorganization and transformation into market-oriented companies.

The share of credit risk and the loss in banks' portfolios has risen sharply over the last three years. Most of the doubtful debts lie with the large state-owned enterprises, but currently private entities are also a source of trouble for banks.

The liberal licensing policy of banking institutions, adopted by the NBP in the early '90s, also caused some important problems. Too many new banks were established with a weak capital base, inexperienced management and inadequate personnel qualifications. Many went into default, forcing the NBP to intervene. In addition, small cooperative and private banks undertook a wide range of activities for which they were not prepared. They extended loans and guarantees exceeding their capacities, borrowing funds from other banks. Large numbers of badly managed banks rapidly started to fall into trouble. In 20 cases, the NBP had to initiate bankruptcy proceedings; in seven, bank management was replaced by NBP-appointed administrators.

The need to introduce a bank-financed deposit protection system is obvious. Because of the overhanging bad debt, industry support is growing for an independent guarantee institution which could accept a portion of the credit risk. In this way, credit risk could be spread among banks, creditors and the guarantee fund. Such an establishment would be a significant boost to small companies which now have to provide 100 percent collateral to secure a loan, thus, in essence, carrying 100 percent of the risk with the loan simply providing easy liquidity.

8.4. Monetary Policy

General Trends in Monetary Policy

The basic problem of monetary policy in the last two years has been the need to neutralize the monetary consequences of the quick increase in foreign currency reserves. Gross official reserves at the end of June 1995 totaled \$10.7 billion, an increase of \$4.7 billion in comparison with the end of 1994 (\$6.0 billion). To stop the increase in gross official reserves, the NBP reduced the monthly scale of zloty devaluation. In September 1994 the monthly scale of zloty devaluation was lowered from 1.6 percent to 1.5 percent, in November 1994 to 1.4 percent and in February 1995 to 1.2 percent. There were, however, reasons for the cautious zloty devaluation pace reduction. Too quick a reduction could result in the real appreciation of the domestic currency, the decline of export price competitiveness and in consequence the worsening of the trade balance and the renewed rise of foreign debt. The reason determining this careful attitude in exchange rate policy was also the necessity to maintain a high level of currency reserves necessary for foreign debt service.

NBP Lending Rates to Commercial Banks

In 1995 NBP lowered lending rates to commercial banks two times, in May and September. Under the NBP President's Regulation, the following lower interest rates were implemented:

<i>Items</i>	<i>May 1995</i>	<i>September 1995</i>
Bills rediscount rate	27%	25%
Refinancing rate	31%	28%
Lombard rate	30%	29%

Required reserves

As of February 1, 1994, commercial banks have been subject to a reserve requirement not only for zloty deposits but for foreign exchange deposits as well. As of February 28, 1995, under the NBP President's Regulation, the reserve requirement for time deposits in zlotys was lowered by one percentage point. The other reserve requirements were unchanged.

Current reserve requirements, as shown below, refer to reserves as of March 1995.

<i>Type</i>	<i>Current requirements</i>	<i>F/X equivalent</i>
	<i>in zloty</i>	<i>in zloty</i>
Demand deposits	20%	1%
Time deposits	9%	1%

Commercial banks also may maintain part of their reserve in the form of declared vault cash, although this may not exceed 50 percent of their total reserve requirement.

Total required reserves increased by PLN 140.8 million from June 1995 to July 1995.

Exchange Rate

A new system of establishing the exchange rate was introduced in May 16, 1995. This system allows for floating changes in the zloty exchange rate on the domestic inter-bank market. However the changes must be within a defined margin around the average rate which is determined on the basis of a basket of currencies. This new average rate is called "NBP central parity rate" and is announced in the morning.

The NBP also fixes a closing rate at the end of the day (called the "fixing"). It is an official rate used for statistical and accounting purposes. It reflects the level of foreign exchanges on the inter-bank market more efficiently than the previous average rate and the present NBP central parity rate.

Both exchange rates (NBP central parity rate and the fixing) are expressed in two currencies: US dollars and German marks. It is also worth noting that the rate of zloty devaluation in relation to the basket of currencies used to establish the NBP central parity rate has been lowered to 1.0 percent as of January 8, 1996.

Review of Selected Banking Data

Items	Unit	December 1993	December 1994	December 1995	April 1996
Rediscount rate	%	29.0	28.0	25.0	23.0
Lombard rate	%	33.0	31.0	28.0	26.0
Refinancing rate	%	35.0	33.0	29.0	27.0
Zloty lending rates, principal commercial banks	%	35.0-55.0	31.0-49.4	24.0-44.2	22.8-29.7
Zloty deposit rates (12 month), principal commercial banks	%	32.0-38.0	27.7-34.0	22.0-25.0	19.0-22.5
NBP average exchange rate, zloty/USD	zloty	2.1079	2.4312	2.4718	2.6214
Free-market average dollar exchange rate, zloty/USD	zloty	2.0867	2.4195	2.4550	2.6057

Source: NBP

9. INSTITUTIONAL INVESTORS

9.1. Institutional Investors

The limited number of institutional investors such as closed-end funds, insurance companies and pension funds is a significant problem of the Polish capital market. High institutional investment reflects capital-market stability and appropriate mobilization and allocation of capital. To accomplish this in Poland, restructuring of the insurance and retirement systems are essential. New regulations should encourage potential investors by providing needed tax relief.

Aware of the problems, the Ministry of Privatization and the Polish Securities Commission are working on a draft of an act on investment funds. Although the current legislation permits establishing closed-end funds as a corporation, their activities are not profitable because of double taxation. The corporation must pay taxes on the gains it makes on its investments. Shareholders have to pay income taxes on dividends.

As a result, only two companies manage four mutual funds at present. Pioneer First Polish Trust Fund Corporation manages three Pioneer Trust Funds, and Korona Trust Fund Corporation manages the Korona Fund.

Banks and insurance companies are the most likely existing organizations to become Polish institutional investors, outside the scope of trust funds. Already they aided the creation of the Warsaw Stock Exchange and most brokerage houses now in business. For example, almost all banks have Capital Investment Departments which invest some portion of their assets in the capital markets. Their involvement in further development of the financial market is likely to be significant.

9.2. Insurance Companies

Although 41 insurance companies have received licenses for providing policies, not all have begun operations. At the end of 1995, 40 insurers operated in Poland, including eleven with foreign participation. The two most powerful insurance companies in Poland are PZU SA and TUiR Warta SA.

The Act on Insurance Activities dated July 19, 1990, gives insurance companies significant latitude in investments but also includes restrictions to assure liquidity and the safety investments. By their nature, well-managed insurance companies are risk-averse. Currently insurance company portfolios are typically divided: 47 percent in bank deposits, 25 percent in T-Bills, 15 percent in equities and 13 percent in other investments.

Regulatory and Legal Structure

The 1990 Act on Insurance Activities regulates the insurance industry in Poland. Legal and institutional solutions in this law are based on models from the European Union. The power to grant and to revoke insurance licenses is vested in the Minister of Finance.

Insurance companies must distinguish between life insurance and other types. Insurers may organize only as either joint-stock companies or mutual companies. Foreign investors may establish insurance companies only in the joint-stock form. By 1999, foreign companies will be able to operate in other forms according to terms and conditions set by the Finance Minister.

A regulation passed by the Minister of Finance in 1990 provides the general principles of financial management for insurers. To protect policyholders, two funds were established: a Guarantee Fund and a Fund for the Protection of the Insured. The Guarantee Fund is for payment of civil liability damages. The Fund for the Protection of the Insured is to satisfy claims in case of insurer insolvency. Both funds are financed through contributions from insurance companies.

Under a new 1996 regulation, if a policyholder seeking a special coverage has been turned down by two Poland-based insurers, the policyholder may purchase the coverage from a foreign insurance company based outside Poland.

Insurance Market Share and Products

The three largest life insurance companies, based on market share, are:

Company	1994 Market Share	1995 Market Share
PZU Życie	94.7%	87.2%
Commercial Union	2.8%	6.5%
Amplico Life	2.0%	4.6%

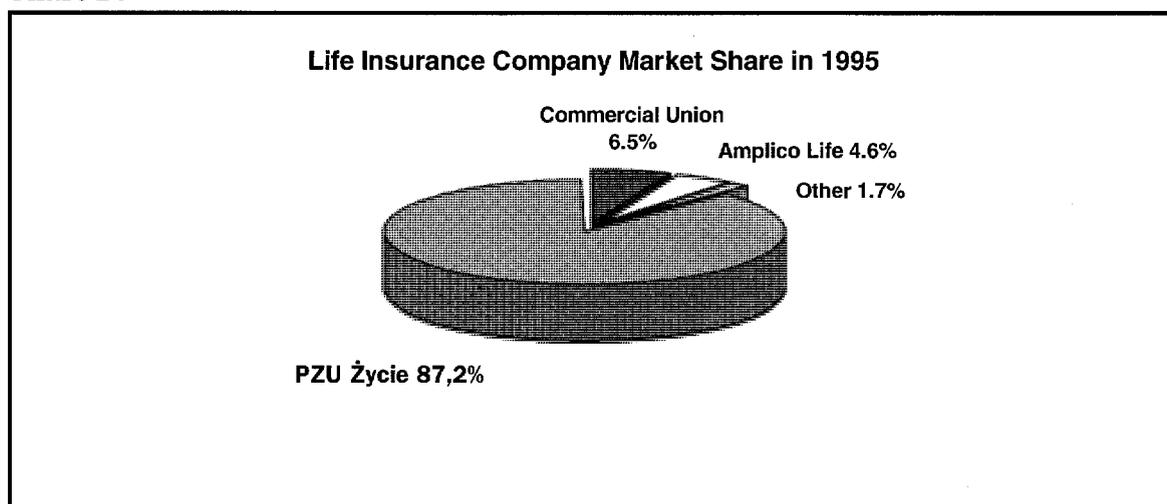
The three largest sellers of property insurance are:

Company	1994 Market Share	1995 Market Share
PZU	60.9 %	60.5%
Warta	19.2 %	17.6%
Polisa	3.4 %	3.3%

Some types of insurance are mandated. Car owners must carry third-party liability insurance for damages. Farmers must carry coverage against fire and other accidents and third-party liability coverage for their farming business. All other insurance is optional.

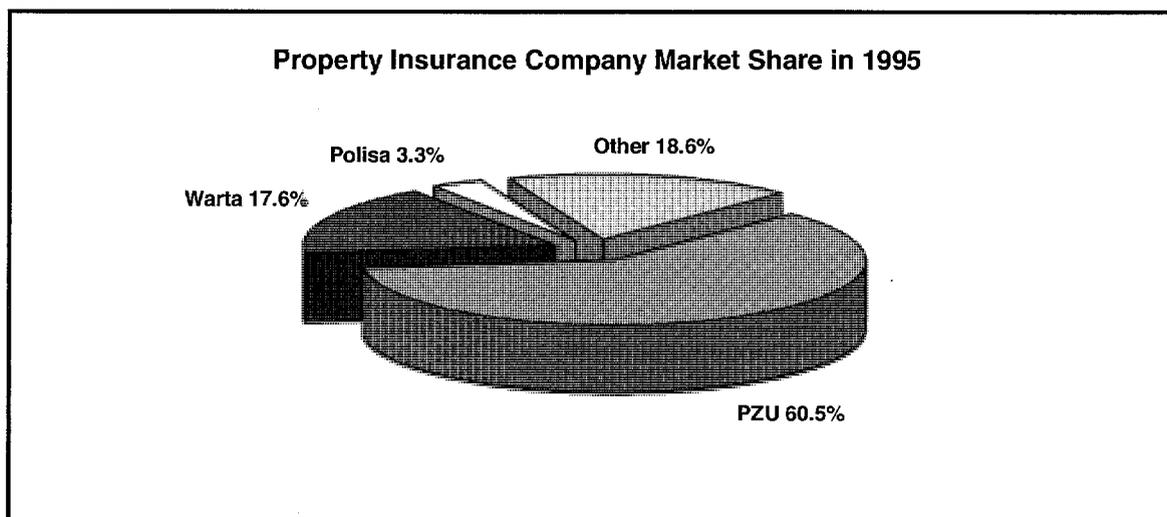
The economic transformation has spawned new coverages and companies. For example, the Export Credit Insurance Corporation (acronym KUKI in Polish) provides insurance for foreign trade transactions. Since 1991, it has insured primarily against commercial risk on the basis of one-year blanket policies (similar to the French COFACE). Coverage is relative to the total estimated export sales of the company. KUKI is a joint-stock company with a majority of its shares owned by the State.

Chart 14



Source: Rzeczpospolita no 116, May 1996.

Chart 15



Source: Rzeczpospolita no 116, May 1996.

Top Insurance Companies

- **PZU SA and PZU Życie**

These companies hold the largest market shares in the property and life sectors. Founded in 1803, PZU offers auto, property and agriculture, farmer's third party liability and fire insurance for farms. PZU is owned by the State Treasury. PZU Życie offers only life policies.

- **Warta SA**

Founded in 1920 and having about two million policies in force, WARTA offers commercial, auto, marine, cargo, personal and aviation covers. The Ministry of Finance has been the largest shareholder. Foreign investors include CS First Boston Ltd., Central European Growth Fund PLC and J. Rothschild Securities Ltd.

- **Commercial Union Life**

Founded in Poland in 1991, the company offers a variety of life insurance products, including a Flexible Protection Plan. It is owned by Commercial Union PLC of England (90 percent) and Wielkopolski Bank Kredytowy (10 percent).

- **Amplico Life and Amplico**

First American Polish Life Insurance and Reinsurance Company was founded in 1990. It offers only life insurance coverage and is owned by American International Group (55 percent) and Bank Pekao SA (45 percent). A separate company, Amplico, offers a range of commercial coverages for business and industry, including entertainment and financial lines.

9.3. Cooperation Between Banks and Insurance Companies

An estimated 10 to 12 percent of the shares of insurance companies are controlled by banks, resulting in strong links between the two sectors. These strong inter-relationships between the insurance and banking sectors are customary in developed economies; Therefore, rumors that new amendments to the Banking Law will impose restrictions to disallow banks from investing in insurance companies are distressing. Insurance companies, by cooperating with banks, can invest their liquid assets efficiently and receive short-term loans while bank deposit accounts can be used to make policy payments whenever necessary.

Life insurance companies find bank networks very attractive for marketing (distribution) of their policies. As a result, foreign insurance companies which established subsidiaries in Poland sought out Polish banks as minority shareholders. A few examples follow. Wielkopolski Bank Kredytowy holds a 10 percent equity stake in Commercial Union Life, and Bank Pekao SA holds 45 percent in Amplico-Life. Commercial Union has signed an agency agreement for distribution of its products with Bank Przemysłowo-Handlowy SA. Bank Handlowy SA holds 10 percent of the shares of the Heros-Life, and 21 percent of the shares of Heros are held by two state banks and 52.5 percent by private banks.

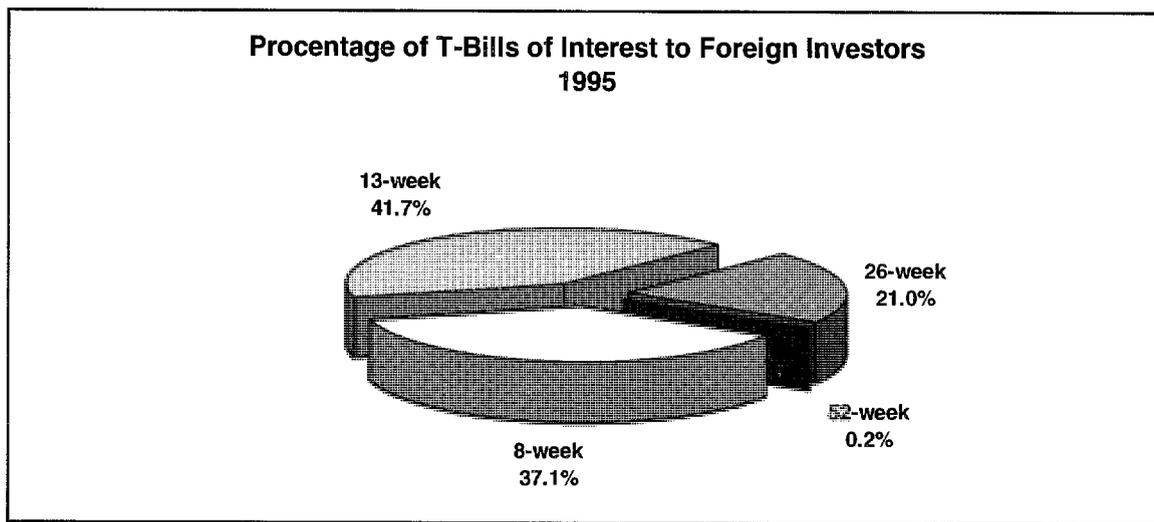
The Polish government intends to create a Polish reinsurance company. Several Polish insurance companies, Stalexport SA, Bank Handlowy SA, Bank Przemysłowo-Handlowy SA and the European Bank for Reconstruction and Development are potential shareholders in the new company.

9.4. Foreign Investors

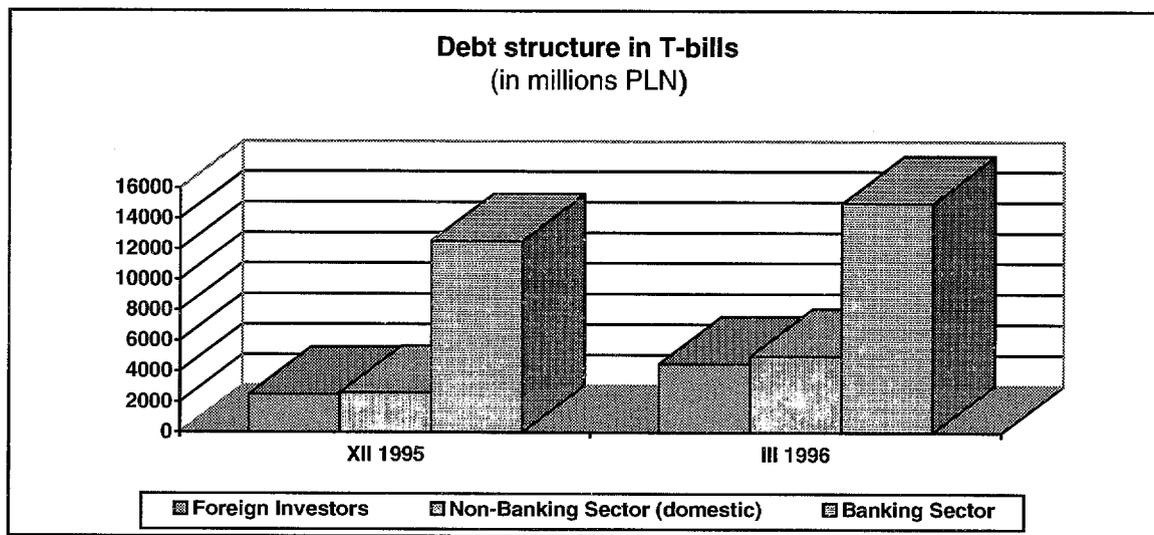
Foreign investors are attracted to the Polish capital markets, and their interest in these markets is increasing. The dematerialized system of trading, growing liquidity on the secondary market, short maturity, simple transfer of capital and profits, and attractive interests encourage foreign investors. They currently hold approximately 12.7 percent of the equities on the Warsaw Stock Exchange and 10 percent of T-bills. (See charts 16 and 17 on the following page.)

According to Ministry of Finance figures, at the end of 1995, the stake of foreign investors in Polish T-bills on both the primary and secondary markets was about PLN 3,000 million.

That stake had risen to about PLN 4,500 million by the end of March 1996. Foreign investors held about PLN 1,000 million of Polish T-bonds on the primary market by the end of 1995. That stake was about the same at the end of March 1996.

Table 16

Source: "Rzeczpospolita" No 160, July 1995

Table 17

Source: Ministry of Finance

9.5. Venture Capital Funds and Firms in Poland

The venture capital funds that operate in Poland can be divided into two categories: those created by parties interested in capitalization of particular investments and those created by State authorities in order to participate in the transformation of the economy.

The following is a listing⁹ of the major funds and firms with operations in Poland:

- **Polish Private Equity Fund I & II.**

The Polish Private Equity Fund I & II were founded in 1992 as closed-end investment funds. Neither comes under the Polish tax law. Each holds capital of \$151 million which came from the Polish-American Enterprise Fund (\$50 million), the European Bank for Reconstruction and Development (\$50 million), Creditanstalt Bankverein (\$7 million) and various US pension funds (\$44 million).

Enterprise Investors manages both funds, which mainly invest in small- and medium- enterprises undergoing privatization. Profits will be realized five to seven years, once a given company is listed on the Warsaw Stock Exchange or is sold to another investor.

- **Polish-American Enterprise Fund (PAEF)** (See Part 4, Sec. 6.)

- **Caresbac-Polska SA**

Caresbac-Polska began operations in Poland in March 1992. Major shareholders are: CARE Small Business Assistance Corporation, Cooperation Fund, Foundation for the Development of Polish Agriculture, Overseas Private Investments Corporation and European Bank for Reconstruction and Development (EBRD).

The fund invests in small- and medium-sized enterprises with 15 to 100 employees. It has raised \$17 million and is not seeking additional capital. At year-end 1994, the fund has committed \$3.5 million and dispersed \$2.8 million.

- **Society for Social and Economic Investments**

Five major shareholders invested in this fund: Bank Inicjatyw Społeczno-Ekonomicznych (28.2 percent), Societe d'Investissement et de Developpement International (24.1 percent), Fundacja Rolnicza (18.2 percent), ESFIN Participation (18.2 percent), Fundacja Inicjatyw Społeczno-Ekonomicznych (11.3 percent). Capital of PLN 9 billion is being invested in small- and medium-sized enterprises. Their portfolio is divided evenly between start-up investments and development finance projects.

- **International UNP Holdings**

The International UNP Holdings fund was founded by Georg Bonar of Toronto, Ont., Canada. In addition to Bonar who holds 1.49 percent, shareholders include: J.P. Morgan Investment Management (18 percent), Morgan Stanley (12.6 percent), Sceptre Investment Counsel (9 percent) and Murray Johnson Int. (8.1 percent). International UNP is a publicly traded holding company with

⁹ Compiled from "Fundusz Inwestycyjne typu venture capital," Transformacja gospodarki, nr. 60 Gdańsk 1995; and "Survey of Venture Capital Funds Active in Poland" prepared by Crimson Capital Corporation January 1995.

a listing on the Toronto Stock Exchange, which makes it unique among private equity investors in Poland.

The company has raised more than \$40 million in several private placements since 1992. It invests in medium-sized enterprises. Commonly the fund purchases a majority stake in order to provide the company with an opportunity for rapid development.

- **PolTrust SA**

PolTrust SA was to begin operations in 1996. The lead investor is Swiss Bank Corporation (60 percent). The fund is managed by BMF Capital, which is affiliated with Business Management & Finance (BMF) International, a corporate finance and management consulting firm created in 1991. The fund will invest in the restructured sectors of mining, energy, manufacturing and the car industry.

- **Poland Partners LP**

This fund, registered in Delaware, US, has a capital base of \$65 million. Investors are all private, including one corporation and nine pension funds. The fund will invest in the following high-growth industries: pharmaceutical and personal care, building supplies and home improvement, food production, financial services, plastics molding, franchised services and automotive after-market.

- **Pioneer Poland Fund**

This is a closed-end fund with capital \$40 million and invests in medium-sized private companies, particularly in the environmental protection, telecommunication, food production, wood processing and textile industries. It is managed by Pioneer Investment Poland, an affiliate of The Pioneer Group of Boston. Lead investors, in addition to The Pioneer Group, are EBRD and Deutsche Investitions und Entwicklungsgesellschaft GmbH.

- **The Poland Investment Fund LP**

The funds seeks to raise up to \$50 million and had raised \$23 million at the end of 1994. Its strategy is to invest in the privatization of former monopoly producers or dominant companies and to participate in start-ups with strategic Western partners who bring management and technological expertise to the project.

Copernicus Capital Management is the Polish investment advisor for this fund and Advent International of London provides international advice. Lead investors are Lombard, Odier & Cie.; Aurelia Finance SA; IFC; EBRD; Abu Dhabi Investment Authority; and Advent Central Europe Fund (managed by Advent International).

- **Renaissance Partners**

Renaissance manages a limited partnership invests in companies with high growth potential in Poland and the Czech Republic. The fund has \$40 million in capital.

- **Agency for Industry Development**

The State Treasury owns the Agency for Industry Development which has capital of PLN 200 million. The Agency helps in the privatization of state-owned companies, granting loans for restructuring and guarantees for loans. The Agency's portfolio is structured as follows:

Financial institutions	28.4%
Industries	70.8%
Other	0.8%
TOTAL	100.0%

- **Program: "Stabilization-Restructurization-Privatization"**

This is a program for medium-sized enterprises with financial problems. For this venture capital fund, the European Bank for Reconstruction and Development has pledged \$40 million to help Polish banks, the State Treasury and/or the Agency for Industry Development to create investment companies.

- **PBG-Investment Fund Ltd.**

The Powszechny Bank Gospodarczy (PBG) in Łódź fund was created to restructure companies whose debts were converted into stocks/shares. PBG provided PLN 3 million while the British Know-How Fund provided PLN 17 million. Its portfolio consists of 25 companies.

9.6. Pension Funds

Although some insurance companies and investment companies offer products which could be used for pension purposes, Poland has no "true" system of private pension funds. The Government, however, is well aware of the need for pension reform and the potential role a private system could play and has begun to act accordingly.

Under a grant from the US Agency for International Development, a report on private pension funds was prepared earlier this year. The report concluded that private pension funds would benefit from tax incentives by stimulating the market for them. At this time the Government offers no financial incentive for private pension funds -- for example, no tax deductions or credits. Yet existing products have marketed well. According to the report, some 400 companies offer Pioneer's investment trust retirement program despite the lack of tax incentive, and employees have been receptive "modestly".

The USAID-commissioned report also concluded that:

- Reform of the public pension system is essential to development of a voluntary, private system in Poland. A key reason is the high financial burden of the public system. At a cost of more than 48 percent of payroll, it makes labor a costly commodity.
- Poland's capital markets and activities can support private pension fund development. Because pension funds seek long-term investments, their development could improve liquidity. The market should become more attractive as a method of raising capital when demand securities increases.
- The current legal and regulatory framework for capital markets must be changed if a healthy new pension fund industry is to develop. For example, concepts such as fiduciary and trust are not well defined in Poland law, yet are essential to protect those investing in pension funds.
- Additionally, the Government needs to create a legal and regulatory framework for private pension funds. This should include incentives to long-term savings for retirement as well as protection for investors.
- Finally, a solid private, voluntary pension system could stimulate reform of the overall pension system in Poland. Its success could demonstrate that private systems are viable alternatives.

The Government has proposed to Parliament several alternatives including reform to ZUS' pay-as-you-go system and development of a mandatory, funded, privately managed pension system and a voluntary private system. (See Part II, Sec. 8.)

10. MUTUAL FUNDS IN POLAND

The creation of mutual funds was made possible when the Polish Parliament enacted the Polish Securities Law on March 22, 1991. The model of the mutual fund is different from other types of investment funds.

This Act defines a mutual fund as a "collective investment of money in securities". The Act only covers establishing open-ended funds. Closed-end funds may be created in Poland under the Commercial Code. The fund must be managed by a trust fund corporation established in the form of a joint-stock corporation incorporated in Poland. The objective of the corporation may be only investment of entrusted money on its own behalf and on the joint account of the participants in the fund. The corporation must act in the best interests of the participants in the fund. The mutual fund itself is not a legal entity. The shares of the fund are not securities and are called "participation units". The fund is created through purchases of these units.

The trust fund corporation has the duty and exclusive right to use the name "Trust Fund Corporation". The manager of the fund creates the fund, prepares the by-laws of the fund, sells and redeems the participation units, and manages the fund. The manager can create and manage more than one fund but is not allowed to move assets between funds. A legal person may be a sole founder of the corporation. There are no obstacles in the creation of a corporation by a foreign person. The nominal share capital of the corporation must be covered in full by monetary contributions and should amount to at least PLN 6 million. The Chairman of the Securities Commission determines the minimum amount of required share capital of the corporation, taking into consideration the number of funds to be managed. The corporation issues only registered shares and is permitted only to manage the fund(s). The corporation may not use the fund to acquire securities issued by itself or acquire securities issued by the founders, shareholders or controlled or controlling entities.

The by-laws of the fund, articles of the corporation, choice of a custodial bank and the members of the Supervisory Board of the corporation are subject to approval of the Polish Securities Commission.

The by-laws of the fund should explain the rules of selling and redeeming of the participation units, the manner and frequency of the valuation of the net assets, the formula for rendering information about its financial condition, the principles of the investment policy, the rules regarding capital gains and dividend distribution, the rules of liquidation fees and commissions.

The participation units must be sold through brokerage houses or through other entities upon approval of the Securities Commission. The corporation must sell the participation units without limitation at prices reflecting the values of the fund's net assets. The corporation may collect a fee, in accordance with its articles of association, when selling or redeeming the participation units.

The unit holder receives a certificate that states the number of participation units purchased or redeemed. Participation units are not transferable. Any income earned by the fund, reduced by the statutory costs, shall increase the value of the fund.

To make redemption possible, the manager of the fund must publish information relating to the fund (e.g., the value of the participation units) at least once a month. The corporation is required to publish separate statements on the financial condition of each managed fund

at least once per fiscal year. This statement must contain a list of securities in the portfolio and their purchase price, number and market value, the status of the other assets and liabilities of the fund, changes in the number of participation units, and changes in net value of assets per participation unit. A prospectus for the fund is not required by the law so far, but its by-laws must be published.

In its investment policy, the manager should comply with the following guidelines:

- At least 90 percent of the value of the fund's assets must be invested in securities admitted to public trading in Poland.
- Up to 10 percent of the value of the fund's assets may be invested in other securities, provided that the price of the securities can be determined at a frequency not lower than that necessary for the valuation of the fund.
- Not more than 5 percent of the value of the fund's assets may be invested in securities of a single issuer; this limitation does not apply to securities issued by the State Treasury or the National Bank of Poland.
- Where the assets of the fund are invested in various securities of the same issuer, the total value of the securities of such an issuer may not exceed 10 percent of the value of fund's assets.
- The average monthly level of liquid assets may not constitute less than 10 percent of the value of the fund's assets.

As mentioned earlier, the custodial bank is authorized by the Polish Securities Commission. The bank is required to:

- Ensure safe custody of the assets of the fund,
- Calculate the net asset value of the fund in accordance with the law and the by-laws of the fund,
- Execute the orders of the corporation, unless these contravene the by-laws of the fund or the law,
- Ensure that in transactions involving assets of the fund, the amounts due are paid within periods defined in the by-laws,
- Ensure that the fund's income is announced in accordance with the law and the by-laws of the fund,
- Liquidate the fund and distribute its assets among the participants in the fund, in proportion to their participation units.

The custodial bank cannot be an incorporation of the trust fund corporation, nor a shareholder in the corporation, nor may it undertake the management of the corporation. The manager cannot use the assets of the fund to buy shares of the custodial bank.

Since the fund has no status as a legal entity, it is not liable for taxes. However, income tax is paid by the management company from its profits. Participation units of mutual funds are offered in Polish zlotys only.

By May 1996, four entities had been licensed to create open-end funds in Poland:

- Pioneer First Polish Trust Fund Joint Stock Company,
- Korona Trust Fund Joint Stock Company,
- Fidelia Trust Fund Joint Stock Company,
- Przymierze Trust Fund Joint Stock Company (Alliance Trust Fund Company).

10.1. Pioneer First Polish Trust Fund

Pioneer First Polish Trust Fund was established by the Pioneer Group Inc. from Boston, Massachusetts, in July 1992. The manager of the Fund and underwriter are Pioneer First Polish Trust Funds Joint Stock Corporation, which is wholly owned by Pioneer International Corporation.

The participation units are offered for sale through more than 500 outlets of banks and private brokerage houses. The minimum investment is PLN 100 (approximately \$40). Only payments in Polish zlotys are accepted. Valuation of the fund takes place five days a week, when the Warsaw Stock Exchange is in session. The load is 5.5 percent for investments up to PLN 25,000 (\$10,200) and has a sliding scale to 2.5 percent for investments above PLN 500,000 (\$200,000).

The Fund was set up after 16 stocks were listed on the Warsaw Stock Exchange. The general investment policy of the Fund is to buy no more than 10 percent of the shares of any single corporation. The goal of the Fund is long-term growth. The net asset values as well as the structure of its portfolio are presented below.

Pioneer First Polish Trust Fund

Selected Data (in PLN) (\$1 = PLN 2.69)	1992	1993	1994	1995
Total assets (end of the period)	1,999,100	911,511,800	1,430,408,300	674,156,500
NAV (end of the period)	1,993,000	851,076,800	1,421,170,000	665,616,600
Number of units	174,544	24,272,518	33,361,919	13,382,584
NAV per unit (7/28/92 - PLN 10)	11.40	35.14	42.59	49.74
Financial results	141,700	212,156,000	453,439,600	119,696,300
Portfolio structure				
main market		27.72%	24.46%	35.71%
parallel market			0.53%	1.23%
unlisted securities, rights		0.31%	0.44%	0.71%
Equities subtotal		28.03%	25.43%	37.65%
Treasury bonds		1.89%	6.11%	9.51%
T-bills		57.66%	64.56%	52.09%
Foreign securities		9.39%	3.46%	0.61%

The manager of the Fund, Pioneer First Polish Trust Fund Joint Stock Company, received a foreign exchange permit from the National Bank of Poland to invest up to 10 percent of the assets of the Fund outside Poland. The manager invests in various Pioneer Funds in the United States.

Pioneer International Corporation, a subsidiary of the Pioneer Group Inc., and Bank Polska Kasa Opieki SA, the custodial bank for the Fund, formed Financial Services Limited (FSL), transfer agent for the Fund. FSL provides accounting services for the Fund and keeps the records of the unit holders.

The net asset value per participation unit of the Fund in July 1992 was PLN 10.00 (\$6.60), about PLN 35.14 (\$17.50) in January 1994, in December 1995 PLN 49.74 (\$20.30), and at the end of May 1996 PLN 63.82 (\$24.10). The total assets of the Fund are PLN 674,156,500 (\$275,165,918) as of December 1995.

The total costs of the Fund, including the 2 percent management fee based on the average monthly value of the assets, cannot exceed 4 percent of the total monthly value of the Fund. The brokers' fees and State taxes are not included in this limit.

In addition to its original fund, Pioneer has launched two additional funds which are described below.

10.2. New Initiatives

The success of Pioneer First Polish Trust Fund has been closely analyzed by various investment groups, both Polish and foreign. When the Fund was established, few predicted success, given the political and economic risk and the barely established Polish capital market. The results of the Warsaw Stock Exchange have had a very significant impact on the Fund's results, even though only 30 percent of its assets were invested in listed stocks.

Pioneer itself recently launched two new funds, Pioneer Debt Securities Fund and Pioneer Aggressive Growth Fund. Unit holders of the Pioneer First Polish Trust Fund are able to make money transfers between the funds. Pioneer also offers a retirement saving plan for its investors.

In August 1995, Korona Trust Fund was launched by Creditanstalt Securities SA and Bank Gospodarki Żywnościowej (Food Economy Bank). The Korona Trust Fund Corporation was set up by both partners. Creditanstalt Securities SA is owned by one of the largest banks in Austria, Creditanstalt. Creditanstalt Securities SA was the first foreign entity to receive a brokerage license. Its Polish partner has the largest network of branches in Poland and was the first to be licensed to advise on trading in securities.

Korona's investment objective is a long-term increase of assets by investing in securities with limited risk. The original value of a participation unit was PLN 50. The load is 5.5 percent for investments up to PLN 25,000 (\$10,200) and has a sliding scale to 0.5 percent for investments above PLN 2,000,000 (more than \$800,000). The minimum investment is PLN 50.

The total costs of the Fund, including a 2 percent management fee based on the average monthly value of the assets, cannot exceed 4 percent annually of the total monthly value of the Fund. Brokers' fees and state taxes are not included in this limit. The net assets value per unit at the end of May 1996 was PLN 67.18.

Two new trust fund corporations have not distributed participation units yet:

- Fidelia Trust Fund Corporation was registered in March 1996. It was created by three Polish shareholders: Fidelia Centrum Ltd. (49 percent), Universal j.s.c (25 percent) and Normico Holding (25 percent).
- Przymierze Trust Fund Corporation was given license on May 1996. It is a joint venture of Bank Pekao SA (51 percent) and Alliance T.F.C. (49 percent of shares).

11. BROKERAGE HOUSES

Brokerage houses are authorized by the Securities Commission to offer securities in public trading and to buy/sell securities in their own name for their clients. A brokerage firm also may acquire securities in its name for its own account for subsequent resale (to the extent specified in the permit for brokerage activity) and may keep securities in custody at a client's request. A brokerage house acting as a dealer must meet certain minimum capital requirements, which are relatively high at PLN 1,000,000 (not less than ECU 360,000, approximately \$446,000). Capital of PLN 130,000 (not less than ECU 50,000, approximately \$61,900) is required for a brokerage house which only intends to collect client orders for acquisition or sale of securities but is not authorized to keep clients' cash and securities accounts.

The Securities Commission's requirements for brokerage firms intending to manage the securities' portfolios of third parties are higher. The minimum required capital is PLN 1,750,000 (not less than ECU 730,000, approximately \$903,700).

The success of market development activities in 1993 and in the first quarter of 1994 has stimulated a growing interest in investing money on the Warsaw Stock Exchange and also in establishing new brokerage houses. At the end of 1994, 54 brokerage houses had been authorized by the PSC (a 50 percent increase over the end of 1993). But the bear market (1994 to the first quarter 1995) and sharp drop in the number of active investors and volume trade on the WSE slowed the trend. In December 1995, 54 brokerage houses operated. The most recent figures show 50 brokerages houses operating in June 1996. Of these, 21 are part of banks and 29 are non-banking brokerage houses.

The whole network of brokerage houses consists of about 715 customer service points, concentrated mainly in the larger cities.

11.1. Banking Brokerage Houses

Currently 21 brokerage houses are departments within banks and manage 631 client service points. These offices allow for direct client contact and have enabled bank-affiliated firms to gain a dominant market position. Because of the financial and organizational support available from their parent companies, they have had an easier task developing a wide network and meeting capital requirements imposed by the Securities Commission than non-banking brokerage firms. This has been a major advantage over non-banking brokerage firms.

The Securities Commission does not currently require that a brokerage unit be a separate legal entity from its banking parent. Furthermore, although a bank's operations in the field of public trading in securities must be organized separately, financially they may be part of the bank. This lack of separation is important because it makes monitoring the financial condition of bank-affiliated brokerage houses more difficult for the Securities Commission and the Warsaw Stock Exchange. Their financial status is further confused because the operating costs of client service points located within bank branches are not separated from those of the bank, and therefore do not appear in the brokerage offices' statement of operating costs.

The bank-affiliated brokerage houses suffer serious organizational problems as a result of the commingling of brokerage and banking functions within the same entity and same operation. Securities accounting and cash accounting often are handled separately as unrelated activities. That is clients have their stock accounts at the brokerage offices while cash accounting is done by the back-office of the bank.

The first bank to separate completely the organization and finances of its brokerage house from its banking operation and to establish itself as a legal entity to provide brokerage activities was Bank Inejatyw Gospodarczych SA (BIG SA). The brokerage house BIG SA is a joint-stock company, and the bank owns 100 percent of its share capital. It is possible that the SEC will shortly call for new legislation for the total separation of banking and brokerage activities.

A key point in the market strategy for a majority of the bank-affiliated brokerage houses is to offer comprehensive services to both small and large investors, actively participating in primary and secondary markets. The brokerage houses hope to enlarge their range of services (management portfolio, financial advisory, custody) and contribute to the creation and development of an Over-the-Counter market.

11.2. Non-Banking Brokerage Houses

The 29 non-banking brokerage offices have at their disposal 84 customer service points for direct client contact (plus 29 headquarters). A majority of non-banking brokerage houses opened during the bear market (from spring 1994 to winter 1995). Their operating philosophy is different from that of bank-affiliated brokerage houses, which benefit significantly from the financial and organizational support of their parent. The non-banking brokerage houses very often are managed by people who invested their own capital to establish the brokerage and are more sensitive to business conditions. The lack of additional capital hinders development of further business on a wider scale, *e.g.*, opening new client services points. They also have difficulties meeting the Securities Commission's capital requirements. Providing better customer service and developing new initiatives are the only routes to a competitive advantage over the bank-affiliates. The capital requirements and simultaneously the bear market in 1994 resulted in banks and large public and non-public companies (Universal, Stalexport, steel mill Huta Katowice) becoming shareholders in the non-banking brokerage houses

Non-banking brokerage houses foresee great opportunity through specialization. They will concentrate on regional offerings and other services not attractive to the bank-affiliated brokerage houses. Customers will be encouraged to open investment accounts through the higher quality services (wider range of analysis of the market situation, recommendations, the level of commission) and special privileges (for example, access to electronic system information) offered by the non-banking brokerage firms.

A non-banking brokerage house also may operate as a affiliate of a banking brokerage firm. This arrangement has some advantages for the non-banking brokerage house. An important one is lower start-up costs. Offices directly trading on the Warsaw Stock Exchange must spend approximately PLN 50,000 to purchase WSE shares, make a deposit to the Guarantee Fund and pay fees for operation on WSE, the WSE membership fee, the information system usage fee, and the National Depository membership fee. As an affiliated office of a direct participant in the WSE and National Depository, the non-banking brokerage firm eliminates these costs but has access to the services.

Through its new Capital Markets Centre ("Centrum Operacji Kapitałowych BH SA"), Bank Handlowy SA specializes in offering such services to the non-banking brokerage houses. Almost 90 percent of the affiliated brokerage firms operate via the brokerage house of Bank Handlowy SA.

11.3. Statistical Data Concerning Brokerage Houses

Although the Securities Commission authorized four non-banking brokerage houses in 1995, the bank-affiliated brokerage houses dominate the market with 80 percent of the total number of securities accounts.

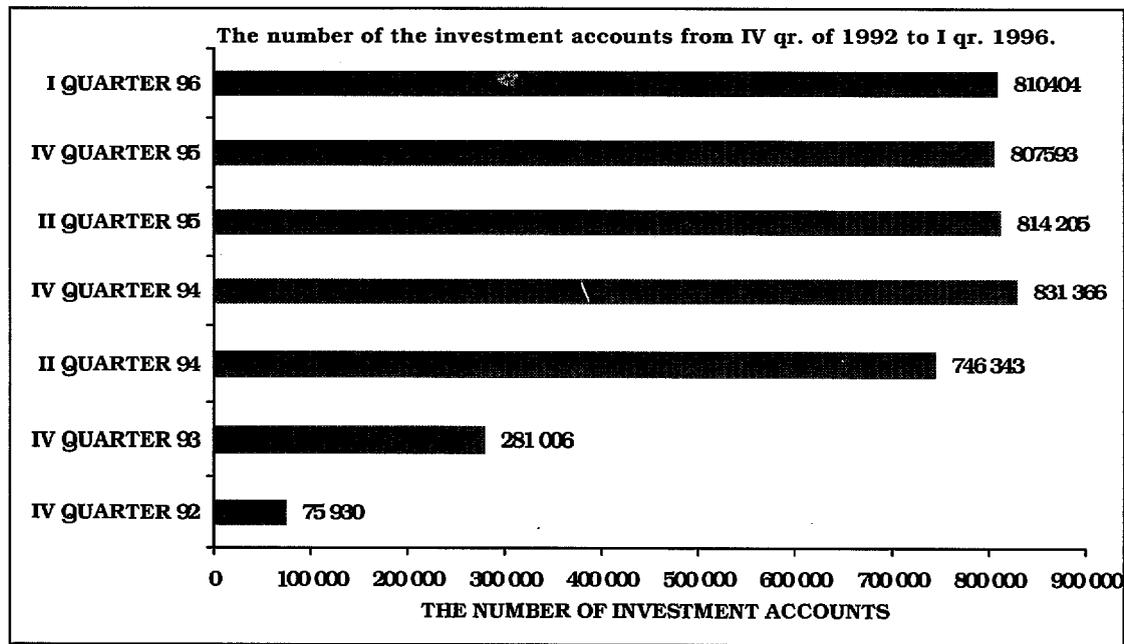
Investment accounts sharply increased (123.9 percent) in the in the first quarter of 1994. This was a direct result of the subscription of Bank Śląski (800,000 shareholders) and the annual announcement of capital gains in 1993. Because 1994 was not as profitable for investors, the number of investment accounts declined in 1995 (about 2.85 percent, from the end of 1994 to the end of 1995).

The total capital of all brokerage houses amounted to approximately PLN 332 million in July 1995. Fifteen brokerage houses (including one bank-affiliated brokerage house) are valued below PLN 1.5 million. However, the total capital of the two largest bank-affiliated brokerage houses amounted to PLN 90 million.

Almost 90 percent of customer service points are provided by bank-affiliated brokerage houses. The Central Brokerage Office of Bank Pekao SA (103 customer service points) operates the largest network overall. Among the non-banking brokerage firms, the largest network is owned by Południowo-Zachodni Dom Maklerski SA (ten customer service points). Most customer service points are in cities such as Warsaw, Kraków, Poznań, Gdańsk, Katowice. A need to find more active investors remains.

Based on the number of investment accounts, the largest brokerage houses are CBO Bank Pekao SA (more than 140,000 investment accounts) and CBO Wielkopolski Bank Kredytowy SA. These two account for approximately 26 percent of all investment accounts. The largest non-banking brokerage house is PENETRATOR SA with approximately 50,000 investment accounts. Other large brokerage houses include brokerage house of Bank Śląski SA and brokerage house of Bank Gdański SA. The non-banking affiliated brokerage houses have a 18 percent share of the total investment accounts.

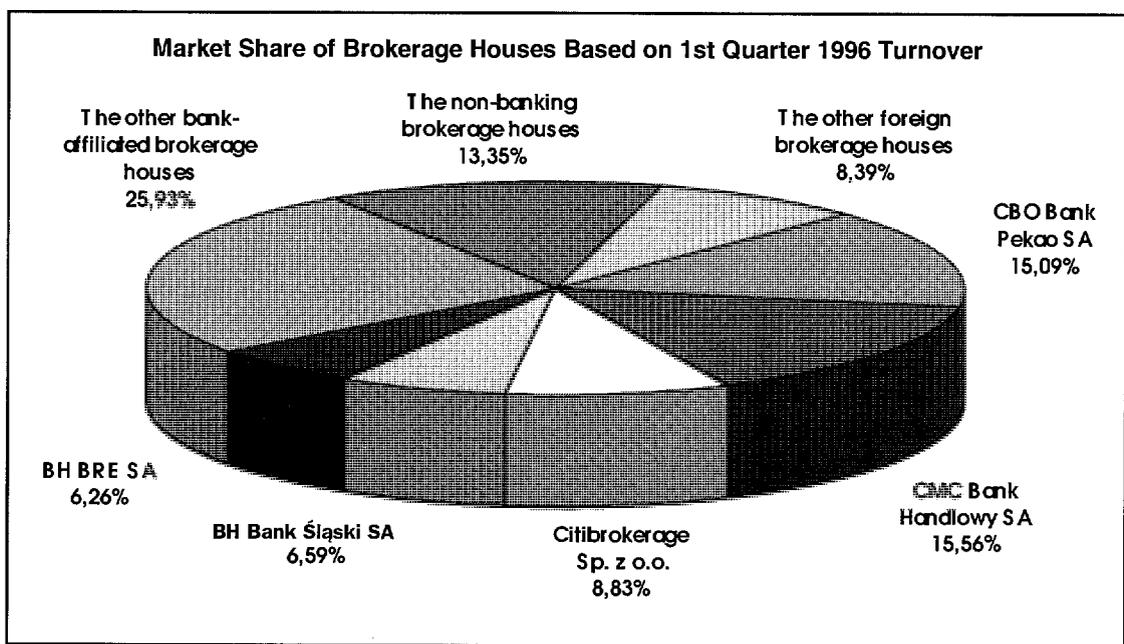
Chart 18



Source: The WSE and the PSC statistics data.

The bank-affiliated brokerage houses also dominate in terms of the turnover value in the equity market. Brokerage houses owned by foreign banks provided only 877 investment accounts, but their stake in turnover value constituted 17.22 percent at the end of 1st quarter of 1995.

Chart 19



Source: The WSE report¹⁰.

¹⁰ including affiliated brokerages

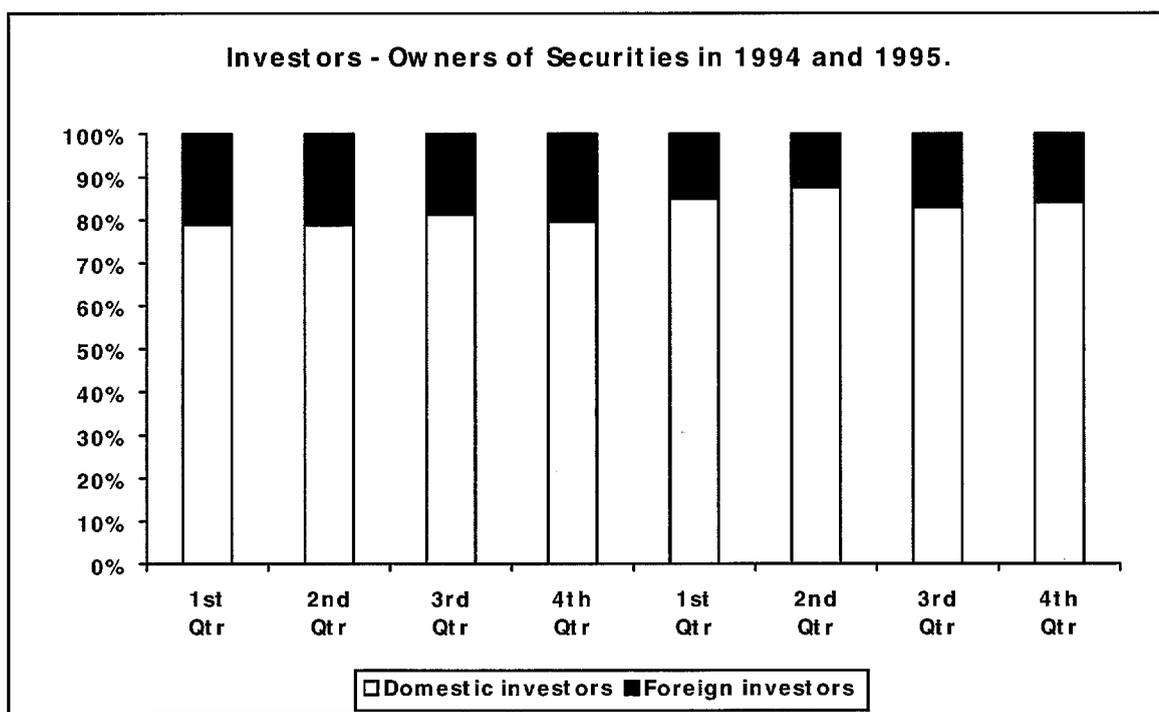
To date, few brokerage houses have specialized. Only a few have a strictly defined strategy for the future. New services, however, are appearing, for example, portfolio management and financial advisory services.

The first brokerage house to offer a portfolio management service was Creditanstalt Securities SA. Bank Gospodarki Żywnościowej SA was the first to be licensed for financial advisory services and subsequently has published monthly reports, including broker's recommendations on the sale and purchase of shares.

Less than 50 percent of brokerage firms acquire securities in their name for their own account and of the those that do, most are bank-affiliated brokerage houses.

The total value of the securities bought by foreign investors accounts for approximately 16 percent of all securities (4th qr. 1995).

Chart 20

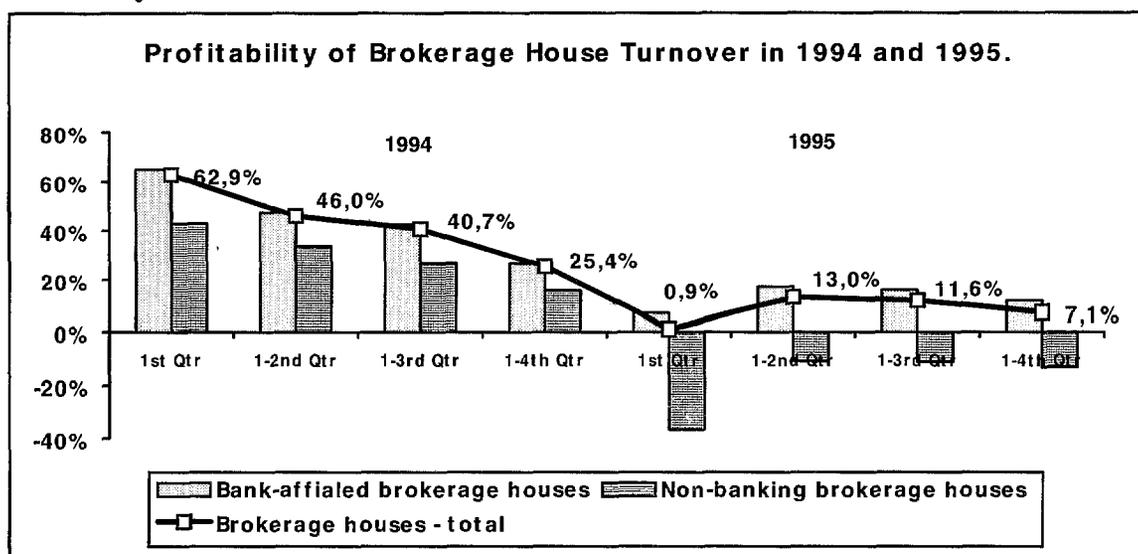


Source: Central Statistical Office report.

Up to now, most institutional investors are from the former large foreign-trade enterprises, rather than trust funds or banks. Since August 1995, only one open-end trust fund has operated on the Polish capital market (See Part I, Sec. 12).

Profitability of the Brokerage Houses

The bull market in 1993 enabled many brokerage houses to record enormous profits. However, with the arrival of a bear market in 1994, the financial situation changed very rapidly. The profitability of brokerage houses decreased each quarter and in the fourth quarter of 1995 fell to 7.1 percent. Bank-affiliated brokerage houses still generate almost 85 percent of all revenue.

Chart 21**Profitability of turnover¹¹ and the level of costs¹² in 1994 and 1995.**

Source: Central Statistical Office report

	Level of Costs in Percent		
	Non-Banking Brokerage Houses	Bank-Affiliated Brokerage Houses	Brokerage Houses Total
I quarter 1994	51.3	34.7	36.2
I-II quarter 1994	65.3	52.0	53.4
I-III quarter 1994	72.3	56.6	58.5
I-IV quarter 1994	81.8	71.7	72.9
I quarter 1995	140.3	94.1	99.3
I-II quarter 1995	111.3	82.8	87.0
I-III quarter 1995	111.6	84.2	88.5
I-IV quarter 1995	112.9	88.5	93.0

Source: Central Statistical Office report

11.4. Factors Affecting Future Development of Brokerage Houses

Several factors will affect the future development of Poland's brokerage houses. These include the following:

Increasing Capital Requirements

The Polish Securities Commission increased capital requirements from PLN 350,000 (ECU 125,000) to PLN 1.1 million (ECU 360,000) in 1994. This had a major impact on non-banking brokerage houses. The long-term bear market in 1994 sharply reduced revenue and unless brokerage houses respond quickly, they may be forced to lower the quality of services, including the safety of acquired financial assets. Many will have to choose one of the following solutions:

¹¹ gross profit/revenue

¹² costs/revenue

- Sufficient capital enhancement
- Consolidation with another powerful brokerage house (mergers or acquisitions)
- Liquidation

Bank-affiliated brokerage houses also are encountering problems. While they have the financial and organizational support of their parent firms, their activity and future strategies are allied strictly to decisions made by their banks' Management Boards.

Economic-Legal Environment

The further development of brokerage houses depends heavily on changes in the legal environment and legal regulations. For example, the stabilization of regulations concerning capital gains are essential. Recently, it was decided to delay capital gains tax for natural persons until the end of 1996. The Government announced its will to keep capital gains tax free till 2000.

The lack of laws governing investment banking hinders the possibility of transforming bank-affiliated brokerage houses into investment banks. Regulating investment banking activities will be a key to determining the strategy of brokerage houses in the future.

Telecommunications

Today brokerage houses are well-prepared and -equipped to deal with a high volume of client accounts and increased volume of data processing. A new challenge facing the brokerage houses and their computer and telecommunications system is the National Investment Funds (NIF) program which will increase the role of the Warsaw Stock Exchange and Over-the-Counter Market when some 300 to 400 new firms enter the capital market.

Telecommunications pose the greatest problem in the development of brokerage houses, particularly links between a main brokerage office and customer service offices, and links between a brokerage firm's main office and the Stock Exchange, and transmission of executed orders. All member-brokers must be able to communicate promptly with the Exchange's trading systems and with maximum security and safety. This cannot be effected unless telecommunications meets certain technical specifications or such a network is developed by the Exchange and brokerages themselves.

National Investment Funds (NIFs)

According to the law on NIFs and their privatization and the Act on Public Trading in Securities and Trust Funds, trading between workers, farmers and National Investment Funds in shares of privatized companies is considered as non-public trading. Some brokerage houses will assist companies in organizing trading and offering other services such as:

- Regulation of the allocation shares between workers,
- Regulation of turnover,
- Training workers in trading, and the rights and obligations attached to shares,
- Preparation and provision of a shareholders book,

- Provision of custodial services,
- Order gathering orders and price setting,
- Transaction settlement.

The Polish Securities Commission has licensed 30 brokerage houses to organize such trading.

Over-the-Counter (OTC) Market

In November 1994 the Brokerage Houses Association regulations for the OTC Market were established. They were presented to the Securities Commission, the Ministry of Privatization and the National Depository of Securities. In February 1995, the Securities Commission presented the draft of the Ordinance of The Council of Ministers, which was welcomed by brokerage houses. The advantages of this project such as open-regulations and its autonomous nature were stressed. The Council of Ministers approved the legal framework for the OTC market (Ordinance of the Council of Ministers, 30 June 1995). The USAID actively participated in its creation, through the allocation of funds to cover start-up costs. Brokerage houses believe that the OTC market will allow them to expand their activities. They expect to see as many MPP companies as possible on the market. This opinion is shared by the Ministry of Privatization, which points out that to effectively evaluate companies and to obtain a correct share price, introducing companies to the public OTC Market is essential.(see Part I, Sec. 3)

Wide Range of Services

The situation on the Warsaw Stock Exchange (WSE) in 1994 and 1995 proved that brokerage houses need to improve and expand their services. Consequently new services have been prepared to encourage investors.

Since 1995, brokerage houses such as BOS have offered their customers free information on the WSE, new issues and selected public companies via an on-line electronic service. Access is available by modem on BBS via Polbox, or through the Internet. Services are free of charge and open to everybody. The basic service offers updated information on WSE sessions daily from 4:00 p.m. Through the Internet, separate information is available on individually quoted companies. BOS supplies the necessary software to access the service.

“DML” offers another electronic service. Once more, access to the electronic service is free of charge to the general public though only DML clients have access to a full range of information. The electronic services include: general information about the brokerage house, information about publicly trade companies, results of WSE sessions, technical analyses, comments, portfolios and forecasts of net profit and ratios. Brokerage houses which provide electronic services want to expand and to use them as promotional tools.

PBK (Powszechny Bank Kredytowy SA), a bank-affiliated brokerage house, introduced a new service -- telephone ordering free of charge. Others offer this service but not free of charge.

Commissions also have seen major changes. A new PSC ordinance facilitates brokerage houses in setting their own commission levels. Previously they needed prior approval of the PSC and commissions hardly differed among firms.. The first brokerage house to radically change its system of commissions was PM 'Elimar," which bases its commission on the activity of investor, not on the value of the transactions.

12. ASSOCIATION OF BROKERS AND INVESTMENT ADVISERS

The Polish Securities Law provides a legal basis for establishing a Brokers' and Investment Advisors' Association. The Association is a self-governing body with obligatory membership. However, because the Association is not a professional trade union, its powers to represent Brokers' interests are limited. The organization, authority, and operations are defined in a Charter of Association, which the Securities Commission approved on October 7, 1991. As of June 1996, a total of 1,519 brokers and 76 investment advisers were registered.

The Association's primary ruling body is a 12-member Council, which meets at least once every third month. Elections to the Council and various committees, committee reports and major policy and budgetary decisions are part of the Association's annual convention which every broker is expected to attend. Board members are not paid for their participation.

The Council's role is to give opinions on drafts of proposed laws, approve the brokers' professional code of conduct, submit petitions relevant to brokers' interests and control the Association's finances. The Council elects one of its members as a representative to the Securities Commission to ensure that the business practitioners' views and interests are considered, particularly in the event of disciplinary action against firm.

While the Securities Commission is empowered to take disciplinary action against a Brokerage House, the Association disciplines individual Brokers. Its relevant body is the Disciplinary Committee, which hears the cases of Brokers who failed to use reasonable care, or contravened the law or professional code of conduct.

At the moment, the Association is pushing new amendments to the Securities Law which will give the Disciplinary Committee the sole power to rule on ethical problems related to a Brokers' activity.

Disciplinary penalties include a warning, reprimand, or fine which may be as high as three times a broker's salary and is payable to charity. In more serious cases, the Disciplinary Committee may request that the Commission suspend a broker's license or strike him/her from the register, thus suspending the right to work as a broker. The refusal of the Commission to do so does not prevent the Association from imposing a fine or another penalty. The two organizations -- the Securities Commission and the Brokers' Association -- may take separate but simultaneous action in cases involving both individuals and firms. A broker has the right of appeal to the Commission against the Disciplinary Committee's decision, within 14 days from formal submission of a ruling.

12.1. Overview of Association

The general purposes of the Brokers' Association are to protect the professional interests of its members and to promote trading practices and professional ethics.

Brokers' and Investment Advisors' Professional Code of Conduct overview

During the 1995 Convention, a Professional Code of Brokers and Investment Advisors was amended. It defines the basic rules of broker conduct based on general principles of ethics and concentrated mainly on conflicts of interest and contacts with customers. The new Professional Code regulates the specific differences between the services provided by brokers and investment advisers.

General rules

- In all cases not covered by the Brokers' code of conduct, resolutions of the bodies of the Brokers Association, judgments of the Association's disciplinary bodies or practices approved by brokers should be followed.
- A Broker should perform his/her duties according to the best knowledge and highest integrity and aim to set the highest standard of service.
- The usage of the firm's office, its equipment or name to conduct similar activity in a Broker's own name is forbidden.
- A Broker is not allowed to collude with another Broker against the interests of a customer.
- Brokers are obliged to keep relevant records with care and accuracy to protect a client assets.

Conflict of interests

- All substantial profits of a broker or a brokerage house resulting from a transaction should be disclosed to the customer before the transaction is completed.
- A Broker is obliged to undertake actions restricting the outflow of information about customer activity.
- A Broker is not allowed to use unpublished information obtained within the brokerage house for his/her own or another's gain.
- If a Broker obtains confidential information, he/she should restrain from activity within this area to assure that fair trade and ethical principles are observed.
- A Broker should have only one investment account and disclose its existence to the Commission.
- A Broker is not allowed to purchase or sell securities after the time limit established by his/her Brokerage House. Limit orders of brokers cannot be filled before customers' orders (provided that the customers' orders were received before the broker's order).

To prevent conflicts of interest, the code determines, as a rule, a division of functions performed by brokers. As a result:

- A specialist is not allowed to trade on his/her own account with securities in which he/she is a specialist.
- A broker can purchase or sell securities in the name of the brokerage house only if the brokerage house is the specialist for the securities.
- A broker who is a member of a Board of Directors or other governing body of an entity issuing securities cannot undertake brokerage activity regarding these securities.

In his/her professional contacts with customers, a Broker should act in the customer's best interest. A Broker who isn't authorized for investment advising should not charge a client for such advice. A Broker should take relevant steps to protect customers from loss which might result from the Broker or Brokerage House's withdrawal from the market.

12.2. Accomplishments and Activities

As a result of changes to the Association's governing statutes, the Association can be more proactive on behalf of its members and industry. The result is clear if one compares the level of the Association's activity in 1994 and 1995.

Offering its perspective to various ministries and other organizations is a major role of the Association. It alerted the board of the National Depository of Securities to areas where its procedures on how dividends are counted and taxed were contrary to the law, and the Privatization Ministry with an opinion on some unclear regulations related to the National Investment Funds. A committee of the Sejm requested and received the Association's comments on the Bank Gdański privatization and the NIF program. Interpretation of Brokers' obligations resulting from the Act on Bonds were a topic covered with the head of the Polish Securities Commission (PSC).

During September 1995 the Brokers' Association joined with the nine self-governing trade unions or "chambers" to engage experts to review and prepare an opinion on those laws which define the regulatory role and operations of such groups. Self-governing trade unions, such as the National Chamber of Auditors and the National Chamber of Physicians and Veterinarians, have mandatory membership and regulatory authority. The experts are paying particular attention to issues related to tax advisers and to Article 13 of the Constitution which defines these groups.

The Association identified a member to take part in the task force which is establishing a futures market within the Commodity Exchange in Poland. In cooperation with the Warsaw Stock Exchange (WSE), the Association decided on the rules and criteria for specialist-brokers and the rules for post-auction offers. Five Association members are participating in the Coordinating Committee of Development of the Stock Exchange System.

Working with the PSC, the Association interviewed brokers who were before the Commission to answer questions about their practices. Professional conduct is an important ongoing task for the Association. After hearing from Brokers, the Brokerage House Association, investors, the PSC and WSE, the Association introduced commentaries to the code of ethics and prepared changes. In 1995, under its auspices,

Brokers were offered a training course in professional ethics and standards. The Association collects and distributes information on available training courses and distributes this free of charge. It also publishes a bulletin and maintains a "job bank".

13. BROKERAGE HOUSES' ASSOCIATION OF POLISH BANKS' ASSOCIATION

The Association of Brokerage Houses was established because of a need for self-regulation by the brokerage houses. Because of a lack of relevant provisions in the Polish Securities Law, its activity is based on the Statute of the Polish Banks Association and its own by-laws. The by-laws determine its purposes and rules by which it should operate. After the last amendments to the Polish Securities Law, the Brokerage Houses Association was granted an observatory and advisory role to the Securities Commission.

For the last two years, the Brokerage Houses Association has developed its activity significantly and become one of the most powerful organizations in the capital markets. A recent accomplishment was to organize the Over-the-Counter Market in Poland for which adequate regulations and technical specifications have been prepared. A Central Table of Offers Company (CeTO) was established in January 1996 with 43 brokerage houses agreeing to take part.

The members of the Association are the Brokerage Houses. Membership is fully voluntary, and one can become a member after obtaining permission for brokerage activity from the Securities Commission, submitting a declaration and paying a membership fee.

The main governing bodies of the Association are a Convention, Presidium and Commission of Inspection. The judiciary body for the members of the Association is a Court of Conciliation attached to the Polish Banks' Association. Every member has one vote, places by its representative from the Brokerage House.

The Association's role is to represent the common interest of its members in the field of the securities' market, particularly to represent the Brokerage Houses to the Government and municipal bodies and other entities operating in the securities market.

The Association fulfills its role by:

- Actively taking part in the preparation of legislation to regulate how the securities market functions,
- Expressing its opinions on securities' market legislation projects,
- Evaluating the functioning of and introducing legislation concerning Brokerage Houses' activities,
- Representing the Brokerage Houses to the Securities Commission, the Warsaw Stock Exchange and the National Depository,
- Cooperating in the field of statutory activity with all participants of the securities market,
- Cooperating with foreign securities' market institutions,
- Forming and disseminating the principles of fair trade in brokerage houses activity,
- Disseminating information about capital markets,
- Developing other activities which accomplish the Association's purposes.

Establishing the Brokerage Houses Association is an important step in the self-regulation of the Polish system of securities law. The development of the self-regulation system is

potentially beneficial by reducing costs of direct government involvement and allowing for a wider representation of practitioner views.

To achieve a more cohesive self-regulatory body, membership should be mandated either by the Polish Securities Law or a law covering such organizational issues. The relevant legislation should also give authority to the Securities Commission as well as the power to approve and require changes in the Association rules.

13.1. 1995 Accomplishments and Activities

Last year was an important one for the Association. The president of the Association became a member of the board of the Warsaw Stock Exchange, and the Association initiated an Over-the-Counter Market (See Part I, Sec. 3). It was also an active year. Among the Association's major activities were:

- Created, recommended and presented information standards and issuing standards for securities' issuers on the secondary market in order to make them uniform with the primary market,
- Recommended minimum commission rates for client fees to prevent unfair competition among Brokerage Houses,
- Established a task force to investigate separating from the Bankers' Association to become a chamber of commerce with independent legal status in order to partner more effectively with other public institutions, increase the individual activity of brokers and brokerage houses, and improve links between brokerage houses (decision on separation was to be made in May 1996 at the Association's convention),
- Recommended creation of a new company, separate from CeTO, to create and develop telecommunications for the capital sector.

The Association also held valuable discussions with the Securities Commission on regulation of the secondary market, turnover of the Universal Share Certificates, method of executing transaction settlements, how securities might be used as guarantees for loans, separation of Banking Brokerage Houses from their bank-owners, and rules relating to what advice a broker can give clients. Cooperation between the Association and the Commission has improved greatly in the last year.

The Association takes part in a separate commission which is working with the Warsaw Stock Exchange and other institutions on a continuous quotation system. Discussions centered on a schedule to introduce the new system.

In cooperation with the Ministry of Privatization, the Association is focusing on the privatization of the Stock Exchange. Discussions are underway but no plans have been formulated. Through the Ministry of Finance's Team for the 8th Program of Strategy for Poland, the Association provided its review and opinions on changes in the Banking Law and Act on Bonds, on the separation of Banking Brokerage Houses from the banks and the legal form and organization of investment banking.

The Association is also interested in the licensing of Brokerage Houses for some types of services. This authority would have to come from the Securities Commission.

13.2. Future Plans

The soon-to-occur dematerialization of the Universal Share Certificates of the National Investment Funds will provide a great challenge to the Association in 1996. The dematerialization will mean that all Universal Share Certificate holder (even those with one certificate) must open brokerage accounts. This raises the question of whether the Brokerages Houses can meet the demand for new accounts and whether, in this situation of high demand, the separation of Brokerage Houses from banks should be insisted upon when that separation likely would result in a reduction of offices to serve the increase in clients.

In 1996 the Association plans to:

- Complete work on a written Code of Good Practices,
- Finish establishment of the OTC Market,
- Create a special body to arbitrate issues between Brokerage Houses,
- Increase the activities in which Brokerage Houses participate
- Resolve issues related to the separation of Banking Brokerage Houses from their owner-banks
- Work on technical infrastructure of both the OTC Market and the Warsaw Stock Exchange,
- Work on new proposals related to foreign investments and trust funds.

14. COMMODITY EXCHANGE

The commodity exchange in Poland is truly a "work in process". Since nothing in Polish law prohibits trading, the newly established Warsaw Board of Trade (WBOT) has begun trading -- operating a cash market three days a week. Other cash market commodity exchanges in Poznań and other cities. Yet major gaps remain before Poland will have a true "commodity exchange" operational.

In the international financial community, the term "commodity exchange" means a futures market in commodities, everything from wheat to foreign currency. Poland is now developing a futures market in commodities. Brokers will trade in contracts which guarantee delivery of a commodity on a specified future date at a price set when the contract is executed. Unfortunately, however, the term "commodity exchange" has been used in Poland to describe the thousands of agricultural wholesale markets and cash exchanges that operate around the country, and that has caused much confusion. For purposes of this paper, the term "commodity exchange" will refer to a futures market and discussion of any cash markets will be identified clearly.

The Warsaw Board of Trade has been established and is operational. With help from the Chicago Board of Trade (CBOT), the WBOT is working to establish a commodity exchange in Poland. To accomplish that, good regulation, a clearing house and international standards are needed. Work on those is underway. In the meantime, the WBOT's cash commodities market has three trading sessions each week. This essentially provides a way for the Ministry of Agriculture to auction surplus agricultural products (wheat, rye, butter).

Warehouse receipts as loan collateral and licensed public warehouses are critical steps in the development of the more sophisticated marketing tool of a futures exchange in agricultural products. With US assistance and a task force of banks, farmers, warehouse owners, insurers and regulators and legislators, progress has been made in this area over the last 12 months.

While much of the impetus for the commodity exchange has come from the Ministry of Agriculture, the WBOT is not limiting itself to agricultural commodities. It is already considering foreign exchange futures.

14.1. Warsaw Board of Trade (WBOT)

The Warsaw Board of Trade (WBOT), established by the Foundation for the Establishment of the Grain and Foodstuffs Exchange, was registered in July 1995 as a joint-stock company. Of 178 shares outstanding, 100 shares are held by the Foundation. The remaining shares are owned by banks and trading companies. The original share cost was PLN 100,000 (about \$41,000). There is a great deal of interest in the purchase of shares. This demand has resulted in a decision to increase capital by issuing new shares in the near future.

The WBOT is organized as a non-profit institution; its shareholders will not receive dividends. Profits will be invested in further development of the WBOT and implementation of new products. All participants in the WBOT have to buy shares; then

they are entitled to create broker institutions. Shareholders have the right to lease their WBOT memberships, and lessees are obliged to hire licensed brokers.

The Chicago Board of Trade (CBOT) is an advisor to the WBOT. The CBOT is supplying technology, standards, logo and training of Polish employees to meet international standards. Under preliminary agreements, the CBOT is providing in-kind contributions of software which will be used to provide market surveillance and price-reporting. The CBOT is expected to take an equity stake in the venture in late 1996.

Work has begun to establish a Warsaw Clearing House for the commodity exchange. It will be a joint-stock company of WBOT shareholders and other institutions, especially financial institutions. A clearing house is essential to futures trading since it eliminates credit risk by guaranteeing transactions.

14.2. Needs and Perspectives

Several needs exist before the commodity exchange can function properly. One major need is for more standardized banking practices with regard to payments and fund transfers. Another is for licensed public warehouses capable of being WBOT delivery sites.

Agricultural products often can be stored after harvest and sold at a time when the price may be more advantageous to the farmer. To benefit from this deferred income, however, the farmer has two needs: a warehouse receipt which guarantees the quality and quantity of what's been stored, and banks or other lenders willing to accept this receipt as collateral for a credit line. Licensed public warehouses are a key to this transaction.

The futures market in "deliverable" commodities (mainly agricultural products) also is hampered by this lack of licensed public warehouses. The commodity exchange must contract with a select group of public warehouses to function as its delivery sites. Thus the exchange can guarantee that the quality and quantity of an agricultural commodity will be available on a specified future date.

Through a grant from the US Agency for International Development, Volunteers in Overseas Cooperative Assistance (VOCA) has undertaken a pilot public warehousing project using 20 grain elevators around the country. The pilot is expected to begin in August 1996 and be concluded in March 1997. Based on the results, the project will be adjusted and expanded. A VOCA task force has proposed a five-level guarantee system for public warehouses. The requirements include:

- Effective licensing process;
- Strong physical examination system as part of licensing and ongoing inspections;
- Assurance that product is always in storage at warehouse;
- Bonding of warehouses;
- Indemnity fund to guarantee safety of product covered by warehouse receipts.

The existing inspection institutions under PISiPAR (Państwowa Inspekcja Skupu i Przetwórstwa Artykułów Rolnych) would be the government agency responsible for

licensing and inspection of warehouses. Local province agencies as well as private companies could inspect the warehouses, providing they are approved by PISiPAR.

To complete these tasks, government assistance is necessary. The government should be involved in preparing relevant legislation, licensing and inspecting warehouses, licensing and regulating commodity exchanges and providing for proper safeguards. Proper warehouse receipts also should be designed and approved by the government.

It is worth a reminder that the public warehousing project is separate from the development of the commodity exchange, though critical to its success. Of the 20 elevators in the pilot warehouse project, only three to five are expected to meet the WBOT's capacity and quality standards for delivery warehouses.

14.3. Modern Commodity Exchange

A modern commodity (futures) exchange trades financial products as well as agricultural products. The principal issues in creating such an exchange include:

Regulatory Structure: government-established regulatory structure for cash markets and futures markets. It is expected that these will be regulated according to a proposed Commodity Act and self-governing regulatory bodies.

Contract Specifications: futures contract, grades, settlements, methods of delivery, trading requirements, price limits, etc.

Structure of the commodity exchange: recommendations for the structure of the commodity futures exchanges, futures clearing house and their ownership structure.

Membership structure: recommendations related to:

- Membership structure,
- Membership classes,
- Pricing and fee structure,
- Responsibilities and duties of the individual trading members
- Responsibilities and duties of the floor brokers,
- Responsibilities and duties of the member firms handling public business,
- Definition of right of access for shareholders.

Trading Practices: regulations for:

- Monitoring and controlling of orders
- Monitoring and controlling of member conduct.

Member Financial Requirements: proposal on general financial requirements for exchange membership (e.g.: minimum capital requirements).

Exchange Personnel Requirements: employment descriptions and staffing requirements for exchange and clearing house personnel, management, and reporting structure.

Control and Supervision: instruments and systems of market control are essential for the further development of the commodity exchange.

Systems: recommendations for computer platform and software application systems, and dissemination of the information.

Initial budget: outline of the future budget requirements including cost of the site, training, equipment and personnel.

Operational budget: forecast of the revenues and costs based on the assumed trends in turnover and the number of participants.

Legal requirements: all the legal requirements for members, brokers and clients to conduct trading.

Exchange status and manuals: complete rule book specifying rights and obligations of market participants.

The most essential aspect for further development of the cash and futures exchanges is that the Ministries of Agriculture, Industry and Trade, and Finance and the Securities Commission agree on an appropriate law to provide legal sanctions for cash commodity and futures trading and make appropriate legal arrangements for regulating cash and futures markets.

14.4. Market Supervision

Regulation of the Commodity Exchange inherently must be different from regulation of the Warsaw Stock Exchange for several reasons. First, their customer bases are different. The WSE is a retail market and regulation focuses on protection of individual investors. The Commodity Exchange is not a retail market. Its customers are commercial enterprises. For example, foreign banks will buy financial futures. Also their "products" are different. A share of stock is a security; it may be used to secure a loan, for example. A futures contract is not a security; it has no collateral value. The Commodity Exchange will require daily reporting by members while the WSE requires monthly reporting.

The question of who will supervise the Commodity Exchange is expected to be addressed in amendments to the Securities Act. The WBOT met with the Council of Ministers after reviewing a draft of a proposed separate Commodity Act and stressed the need for the proposed act to give the necessary authority to regulate to a regulatory body and to give the Commodity Exchange the authority to control its members. It also emphasized the need for a commodity clearing house, and work already is underway to establish this key entity.

The proposed amendments will address cash and futures commodity markets. They will place regulation of the Commodity Exchange under the Securities Commission. They also will establish a legal basis for the clearing house. The amendments are expected to be introduced later in 1996.

Part II.

**LEGISLATION GOVERNING
DEVELOPMENT
OF SECURITIES MARKETS**

1. SECURITIES REGULATION

1.1. Present Regulation

The "Public Trading in Securities and Trust Funds Law" Act, adopted by the Polish Parliament on March 22, 1991, (amended on October 9, 1991, and in December 1993), was a significant addition to the package of legislation adopted to serve Poland's emerging market economy. Unless appropriate legal safeguards were provided to investors, no capital market could have been established.

Beyond setting the rules of the game for the securities market, it introduced the basic entities necessary to form a well-regulated market: Securities Commission, Stock Exchange, National Depository of Securities, brokerage firms, brokers and mutual investment funds.

In most market economies the prevailing model is that of capital market self-regulation. Under such a model, the judgments of a State Security Commission (or an equivalent), the resolutions of a brokerage self-governing organization and the Stock Exchange bodies all serve to implement either the law or regulations derived from the law. The Polish Securities Law drew on this foundation as well. It provides for arrangements already tested and proved in other countries, adjusted to the requirements of the Polish legal system.

In Poland, the Polish Securities Commission (the Polish acronym is KPW) is the main body undertaking most legislation initiatives. It is responsible for, among other things, general supervision of the market and active participation in its creation and enhancement. As the legislative process continues, the Commission is actively engaged proposing numerous amendments to the Act. The Brokers' self-government organization is responsible in particular for ensuring that a professional code is observed in transactions.

1.2. Current Needs and Further Changes

The development of a sound market infrastructure is a dynamic and continuous process. As Poland gains experience in the full range of securities and investment activities that are likely to take place in its emerging market economy, a strong need for further enhancements and changes to legal infrastructure will continue to exist.

The Act on Public Trading in Securities and Trust Funds originally was intended to focus on the public trading of securities, all of which now takes place on the Warsaw Stock Exchange, on reports by publicly-traded issuers and on the licensing of brokerage firms and individual brokers participating in the public trading market. The Commission's proposed amendments generally are consistent with this philosophy. The amendments have improved the Act and enable the Commission to deal more effectively with issues of market regulation and development, which is likely to take place in the near future.

The following is a summary of legal improvements proposed by the Polish Securities Commission (PSC), and passed by the Parliament:

- Improved authority to grant exemptions.

This amendment permits the Commission to grant exemptions without having to rewrite the law. For example, it allows the Commission to authorize a brokerage firm to engage in securities activities not included in Article 21 (e.g., to trade in non-public securities). At present, if a brokerage firm wishes to engage in activities such as acting as a dealer for its own account, it has to receive a permit from the Commission, even though it may have already a permit for other activities. It also allows the brokerage houses to establish a secondary market for Universal Share Certificates which have been issued under the Mass Privatization Program.

- Independence of the National Depository of Securities (NDS).

The National Depository is to serve as a clearance and settlement institution for all publicly-traded securities in dematerialized form, whether on the Warsaw Stock Exchange (WSE) or on the future Over-the-Counter Market. This helps to ensure its independence from the WSE and increase the likelihood that it will service other exchanges more fairly.

- Recognition of a brokerage firm self-regulatory organization.

Currently the Act provides for two types of self-regulating organizations (SRO): the Stock Exchange and the Association of Individual Brokers and Investment Advisors. However, the role of these two organizations is limited. The Stock Exchange can regulate only brokerage firms which are elected to be Stock Exchange members and only their transactions on the WSE. The brokers organization's authority is limited to individual conduct.

- Amendment to Securities Act to allow creation of a self-regulatory organization of Brokerage Houses.

This amendment recognizes the limitations of the current law and provides that entities running a brokerage or advisory firm may associate in a commercial chamber which, in turn, can regulate their operations. Currently a Brokerage Houses Association is organized under the auspices of the bankers organization and is developing its operations rapidly.

- Improved brokerage firm reporting and accounting requirements.

An amendment to Article 32 enables the Commission to determine and set requirements for all information about the financial situation and activity of a brokerage firm. The time limit and scope of information were established by the Chairman of the Commission in Ordinances dated March 17, 1994, and April 15, 1994. The first Ordinance determines the requirements of the brokerage firm regarding the minimum amount of its funds and the maximum amount of credits for brokerage activities. The latter establishes for the brokerage firms the detailed transactions and settlement procedures, rules for recording such transactions and procedures for securing debts with securities admitted to public trading.

- Prospectus delivery requirements.

These amendments generally concentrate on giving the Commission more power to determine and control the extent and form of the presentation of information required to be disclosed by issuers or any entity publicly floating securities before public flotation and afterwards. The Ordinances of the Council of Ministers dated October 11, 1994, determine the requirements of the prospectus needed for admission to public trading on the stock exchange and the information memorandum for the securities to be admitted to the Over-the Counter market.

- Issuer reporting and continuous disclosure obligation.

Current requirements for publicly-traded issues recognize the importance of timely disclosure of financial information. The Chairman of the Commission by an Ordinance dated June 16, 1994, determines the requirements of the issuer to provide current and periodic information simultaneously to the Securities Commission, the Stock Exchange and the information agency (Polish Press Agency - PAP).

- Simplification and improvement of takeover provisions.

The proposed changes are aimed generally at improving information disclosure standards and simplifying the law. It shifts some authority to the Stock Exchange, as long as the Exchange's by-laws are consistent with the general principles for equal treatment of all receivers and a full disclosure of the inviting entity's intentions.

- Organization of the Commission

The members of the Commission shall be comprised of representatives from the Minister of Finance, the Minister of Privatization, the President of the National Bank of Poland and the President of the Anti-Monopoly Office. Former members of the Securities Commission (representatives of the Stock Exchange, the Association of Brokers and Investment Advisers, and Brokerage Houses Association) may participate in meetings of the Commission as advisers only.

- Over-the-Counter Market regulation

The Securities Law gives the authority to the Council of Ministers to determine the forms of regulated secondary public trading in securities outside the stock exchange. The Ordinance of the Council of Ministers dated June 30, 1995, regulates trading on the Over-the-Counter Market. (See Part I, Sec. 3)

While it is not the role of this report to offer recommendations on Securities Law reform nor to review the Commission's progress to date, clearly several areas should be addressed in the next few years:

Banks operating Brokerage Houses

Banks operating brokerage firms might be required to organize brokerage firms as separate legal entities. This requires some changes in the Polish Banking Law (the equity of the brokerage firm shall not be considered within the 25 percent limit of total bank's capital involvement on the market) as well as in the tax law (avoiding double taxation of the brokerage firm and the bank).

Custodial Banks

As there are no regulations concerning custodial services in Poland, the Securities Commission should be allowed to determine some aspects of these services: the minimum funds of custodial bank, procedures, accounting and reporting principles, and rules of separation of customer accounts from the assets of the custodian, are among the most important.

Anti-fraud

The Polish system of securities regulation is focused on the public trading of securities. Substantial need exists to introduce a general anti-fraud provision which would give the Commission the right to undertake relevant steps in cases of fraudulent securities activities, public or private, by licensed or unlicensed financial intermediaries or other persons.

Easier underwriting

The existing practices of underwriting new issues in Poland should be examined. Current delays between underwriting and public offering have disadvantages for investors because the conditions of underwriting are not known when the securities are offered. The Commission, as a part of its market development responsibilities, should take some initiative in the area of improving Polish underwriting practices. The Securities Commission should be able to determine which entities will be allowed to underwrite a new issue of securities.

1.3. Proposed Changes to Act

Because of the level of development of the capital markets, the Act requires changing. The proposed changes seek to:

- Consolidate regulations about the Stock Exchange and the secondary market into one chapter of the Act,
- Broaden the section related to the National Depository of Securities (NDS),
- Consolidate portions relating to professional secrets and confidential information,

- Define more precisely the meaning of:
 1. "Public sales" (sale of securities to the public),
 2. "Underwriting guarantee,"
 3. "Securities in public sales"
- Specify who can join and how a consortium offer an underwriting guarantee,
- Define more precisely the activities that can be undertaken by a broker and by a dealer,
- Determine what activity can be undertaken without prior permission from the Securities Commission, especially related to analysis of capital markets and how legal entities can participate in capital markets,
- Create legal bases for development of new financial instruments so that futures and options can be treated as securities,
- Specify that only de-materialized securities are available for public sale,
- Initiate changes to prepare the market for continuous price quotation system by linking the moment of change of ownership of a security with the moment it is recorded in the NDS,
- Make it possible for Brokerage Houses to offer clients the ability to buy shares on credit,
- Develop a project to start a fund for civil liability.

2. ACT ON BONDS

The first Act on Bonds was passed on September 27, 1988. It established rules for issuing, selling, acquisition and redemption of bonds. The Act itself did not suit the rapidly developing capital market environment. A new Act on Bonds, enacted in summer 1995, supersedes the old one and covers all areas related to bonds.

2.1. Overview of Current Act

The Act identifies which entities may issue bonds: legal persons, local authorities, inter-commune associations and all other legal entities authorized to issue bonds on specified legal bases. The provisions of this Act do not apply to bonds issued by the State Treasury or the National Bank of Poland (NBP).

The Act allows bonds to be issued as securities in series, wherein the issuer declares that it is a debtor of the bondholder and is obliged to redeem the bond. This specified performance may be pecuniary or non-pecuniary. A pecuniary performance means repayment of the principal debt and subsequent interest. A non-pecuniary performance may consist, for example, in granting the obligee the right to share in the future profits of the issuer or to exchange the bonds for company shares. The Act does not limit such in-kind services.

Bonds may be registered or made bearer. During issuance, the issuer may introduce a prohibition or limitation on the transfer of registered bonds.

The liabilities resulting from the bonds may be secured in full, in part or not at all. Full security consists of establishing a pledge or mortgage or obtaining a warranty from one of the following: the National Bank of Poland, the State Treasury, a foreign bank, an international financial institution with its own capital equal to not less than the equivalent of ECU 10,000,000, or a gmina (local authority).

An issuer of unsecured bonds must adhere to strict requirements. First, it must present financial results for the previous three years. In addition, it must ensure that its capital and own funds are equal to or greater than five times the value of the share capital specified in the Commercial Code.

The issuer is liable with its entire property for liabilities resulting from the bonds. Entities which secured the bonds are liable to the amount of security granted.

According to current regulation, the value of a bond issue is not limited. Issuance may be conducted by public subscription or by individual offers to less than 300 persons. When an issue is made through public offering, the issuer is obliged to prepare either a prospectus or information memorandum, depending on which market the issuance will be listed. The time limit for subscription to bonds cannot exceed three months from the date the public subscription commenced.

Representative banks are the new players in the Polish capital market. A bond issuer is obliged to reach an agreement with a so-called “representative” bank which performs the function of a statutory representative of the obligee in terms specified in the statutory act and the contract of representation. Banks may not perform this role when:

- Members of the management of the bank are debtors of the issuers;
- Employees at the bank are related to the person introducing securities of this issuer to public trading or to the issuer;
- The bank owns the entity of the issuer.

The obligations of the representative bank with respect to the obligees specifically include:

- Performing a periodic analysis of the financial standing of the issuer,
- Answering inquiries of the obligees concerning the issuance
- Submitting to the obligees, at least once every six months, a statement confirming that material changes have not occurred for the issuer,
- Immediately notifying the obligees of the financial standing of the issuer, if such circumstances would cause an actual threat to the capacity of the issuer to perform its obligations.

The representative bank must take necessary measures to protect the rights of the obligee if the bond issuer has violated the terms of the issuance.

3. FOREIGN INVESTMENT PARTICIPATION AND FOREIGN EXCHANGE LAW

The demise of the planned economy and advent of a market-oriented economic system in Poland resulted in a significant interest by foreign investors of all kinds. A subsequent influx of foreign capital has necessitated changes to bring Poland's laws and regulations more in line with Western countries. For example, the most recent changes to the Foreign Exchange Law (December 2, 1994, as amended in October 27, 1995) adopted the same foreign exchange standards as European Union law.

3.1. Direct Foreign Investment Participation

Foreign investors may operate in Poland by:

- Establishing a representative office,
- Creating a limited-liability company or joint-stock company,
- Establishing a joint venture with Polish or foreign partners (by either establishing a limited liability or a joint-stock company, or acquiring shares in an existing Polish company).

Foreign natural and legal persons, including banks and foundations, may establish a representative office in Poland. Their permitted scope of economic activities is defined in the license granted to establish the office. Representative offices are governed by Polish law, including fiscal and accounting regulations.

The minimum capital of a limited-liability company amounts to PLN 4 000 (less than \$2,000) and must be fully paid on incorporation. The minimum value of each share must be PLN 50. A limited-liability company may not issue bearer shares, and shares may not be offered to the public. It must have a management board comprising of one or more members, who do not have to be shareholders. A supervisory board (board of directors) must be established if the company's capital exceeds PLN 25,000 and it has more than 50 shareholders. A shareholder's liability is limited to the amount of contributed capital. Tax liability is an exception. Under tax legislation enacted in February 1993, shareholders are liable personally for all of the company's tax liability in proportion to their share of profits.

The minimum capital to create a joint-stock company is PLN 100,000 (about \$40,000). At least 25 percent of the capital must be paid in cash on incorporation. The minimum nominal value of each share must be PLN 1. The company may issue registered and bearer shares, ordinary and preferred shares. Only joint-stock companies may listed on the Warsaw Stock Exchange. A Supervisory Board is obligatory if the company's capital exceeds PLN 500,000.

A permit is required to establish a joint venture only if the scope of activity includes:

- Operation of seaports and airports,
- Dealing in real estate or acting as an intermediary in real estate transactions,
- Defense industry, which is not covered by licensing requirements,
- Wholesale trading in imported consumer goods,

- Providing legal services,
- Joint venture to be established between a foreign investor and a state-owned enterprise, and this enterprise is to make an in-kind contribution consisting of a separate enterprise, real estate or a part of an enterprise which is capable of being used for specific business purposes, in particular a plant or part of an enterprise.

The permit is issued by the institution, which issues a relevant license. In other cases permits are issued by the Minister of Privatization.

After payment of taxes, a foreign company may purchase foreign currency at a foreign exchange bank up to the amount of its profits. To do so, the company must present a certificate issued by the body which audited the company's annual financial statements. These profits may be repatriated without the need for a separate foreign exchange permit.

Foreign employees have a right to purchase the equivalent sum of their after-tax remuneration in hard currency and to repatriate it without a separate foreign exchange permit. The hard currency for such transaction is purchased on the basis of a personal income statement issued by the employer.

3.2. Foreign Exchange Law

The main difference between the 1989 Foreign Exchange Law and the 1994 version is that now legal entities may hold foreign currency in bank accounts and treat them as investments, rather than be required to re-sell foreign currencies to authorized banks.

The October 1995 amendment to the Foreign Exchange Law and changes in General Foreign Exchange Permits dated December 10, 1995, specifically benefit exporters who now have greater opportunities to manage their money and investors who now can invest earned foreign currency on domestic market and abroad. The previous requirement to sell convertible currencies obtained from exports and to transfer them to a foreign exchange bank was repealed. This eliminated the so-called exchange-rate losses connected with the purchase and sale of foreign currencies.

A 1995 permit allows domestic persons to acquire securities issued abroad and coupons attached to such securities, shares and stock in foreign companies, and other similar rights, either by way of inheritance or a gift.

The next important changes in the foreign exchange permits were in March and April 1996. Based on an Ordinance of the Minister of Finance dated March 22, 1996, domestic persons are allowed to transfer abroad hard currency to:

- Buy shares or stock in companies in OECD countries,
- Create a foreign branch or whole company abroad,
- Buy real estate needed to run a business.

Domestic persons are allowed to grant credit and obtain loans from those foreign banks listed in an Ordinance dated April 29, 1996, to finance domestic investment. Both creditor and lender must inform National Bank of Poland about such credits and loans.

Now all Polish domestic persons may open accounts in banks in foreign countries. Payments between domestic and foreign persons may be made in foreign currency without any special permit. Companies now may decide in which currency they want to open bank accounts in Poland.

The Polish Securities Commission has authorized public trading in Poland of foreign securities (limit of ECU 200,000,000).

Polish joint-stock companies may sell part of their share outside Poland and may pay dividends to their foreign shareholders without any special permits.

Foreign partners also have a right to transfer the amount obtained from the sale or redemption of shares as well as the amount due in case of liquidation of a company or due as compensation for expropriation or other measures equivalent to expropriation.

4. TAX SYSTEM ON CAPITAL MARKETS

Tax legislation is drafted by the Ministry of Finance. This may be submitted formally to the Parliament by the Government (Council of Ministers) or by a group of deputies in either house of the Sejm or President. The internal system of review, revision and passage is similar to that in the US. Once a law has been enacted (signed by the President), it must be published in the Journal of Laws. (*Dziennik Ustaw*)

On the basis of tax legislation, the Minister of Finance may issue an ordinance or decree which describes in detail tax payment rules. The following sections describe the major taxes affecting both business and individuals in Poland, as well as those specific to the capital markets.

4.1. Taxes Affecting Businesses in General

Corporate Income Tax.

The February 15, 1992, Corporate Income Tax Act describes income tax rules for legal entities and organizational entities that are not legal entities with the exception of partnerships. If a taxpayer has its domicile in the territory of the Republic of Poland, it is taxed on all its income regardless of where the income was earned. If it has no seat or administration in the territory of the Republic of Poland, then only income earned in Poland is subject to tax.

Income is defined as a surplus of revenues over expenses; various deductions are allowed for business-related expenses. One important deduction is a loss carry-forward. Losses may be carried forward for three years in equal installments. This helps new enterprises which might experience early losses. The corporate tax rate is 40 percent on gross profit.

Dividends

Dividends generally are taxable at a rate of 20 percent, and the tax is withheld by the company paying the dividend.

Dividends are not taxed if that income is used in the tax year it was received to purchase shares from the State Treasury, Treasury bonds or shares in former state-owned enterprises which are now traded on the Warsaw Stock Exchange (primary market only). The National Investment Funds do not pay taxes on dividends paid by Polish companies.

For foreign-based companies, the tax rate on dividends is less than 20 percent if a double-taxation treaty exists between Poland and the country concerned. The tax is usually limited to 15 percent. As a rule, when an investor holds at least 25 percent of the equity of a company, dividend taxation cannot exceed 5 percent.

Interest

Interest earned on bank accounts, loans, Treasury bonds and other securities is taxable at a rate of 40 percent. Interest on bank accounts for a foreign taxpayer (natural or legal) is taxable at 20 percent.

A taxpayer which is incorporated in a country with which Poland has double-taxation treaty usually does not pay income tax in Poland. When the agreement provides that the tax is to be collected at the source, as a rule the amount is limited to 10 percent of the gross amount due.

Capital Gains

Generally capital gains are subject to taxation. They are added to other income sources and taxed accordingly. The tax rate is 40 percent.

Value-Added Tax and Excise Duty

The value-added tax (VAT) is paid by all purchasers of goods and services which aren't exempt from this act. Examples of goods and services exempt from VAT include most products of the meat industry, forestry and hunting; an array of services from agriculture to technology development and financial services (excluding buying/selling foreign currency and leasing services); import of some goods exempt from customs duty; and re-sale of second-hand goods. The rates are 22 percent, 7 percent and 0 percent in the case of export of goods and services .

Producers and importers of certain goods are subject to excise duty. Among these goods are tobacco products, alcoholic beverages, automobiles and engine fuel. The amount payable is based on the turnover of excisable goods and, in the case of import, on the custom value plus appropriate customs duty. The Minister of Finance determines the rules of excise duty within the limits of the Law on VAT, dated January 8, 1993.

Import Tax

All imported goods are subject to a 3 percent import tax (it had been 6 percent in 1994). This is levied on the customs value of the goods, that is, the import value plus custom duty. This tax is gradually being phased out.

Real Estate Tax

Real estate taxes are levied by the local authorities (gminas) and therefore will vary. However, all real estate is subject to a local tax which must be within the limits described in a Ministry of Finance decree of December 7, 1994.

4.2. Investment Tax Reliefs

Government regulations published in 1994 introduced investment tax relief for all business entities, regardless of the type of ownership. However, certain conditions must be met:

- There can be no outstanding payments to Fiscal Office, Social Insurance Fund or Labor Fund.
- Proper documentation confirming the investments must be possessed; for example, VAT invoices or custom clearance documents.
- Other specified requirements must be met.

General Tax Relief

The five cases in which a deduction is possible are:

1. Initial investment of at least ECU 2,000,000 -- Must be made before commencing business activity; may be deducted from revenue in a given year and in the next three years (up to 25 percent per year);
2. Exporters -- If the company's profit from exports is more than 50 percent of export revenue or if the export revenue in a given year exceeds ECU 8,000,000, taxpayers may deduct investment expenses from the revenue. Possibility of 50 percent revenue deduction;
3. Licenses, patents, results of domestic research and development projects -- Purchases and installation of machines and devices in connection with the listed activities may be deducted from taxable revenue. Possible 50 percent revenue reductions;
4. Sale of sea products and processed fish outside Poland (SSW 234) -- Taxpayers who sell sea products and processed fish profitably outside Poland to foreign parties may deduct their investments in machines and devices (up to 50 percent of revenue).
5. Profit margin -- Profit of a company must be 4 percent of revenue in the case of food processing and construction companies or 8 percent of revenue in other cases. If a taxpayer meets this condition, it may deduct all or part of its investment expenses from taxable revenue. Maximum deduction not to exceed 25 percent per year.

Medicines, Medical Equipment, ISO 9000 Relief

In addition, taxpayers who buy machinery or equipment or construct buildings to establish a high-quality security system for production of medicines or medical equipment or to implement a certified ISO 9000 quality system may deduct these costs up to 50 percent of taxable revenue. Additional tax relief is available in subsequent years as well.

Investment Reliefs in High Structural Unemployment Regions

To encourage investments in regions of Poland with high structural unemployment, the Council of Ministers passed a resolution providing tax relief if employment is increased by the investment. Companies may deduct from taxable income up to 50 percent of investment expenditures (reduced by State or local subsidies as well as VAT). The growth factor to qualify varies with the base employment of the company, and employment increases must be calculated in terms of full-time employment.

If a business is stated or operates in an administrative unit (gmina) with less than 5,000 inhabitants, the business has the right to an investment deduction of taxable income up to 75 percent of investment expenditures. The list of regions eligible for this tax relief is included in the Council's resolution and includes more than 400 gminas.

4.3. Taxes Directly Affecting Capital Markets

Transaction taxes and duty stamp

In public trading, the transfer of securities is free from duty stamp charges. In non-public trades, a transfer of shares is subject to duty stamp charges unless it forms part of a business activity. The duty stamp charge rate is 2 percent of the value of the transaction. No duty stamp charge is levied on transactions (secondary market) on the Universal Share Certificates issued under the Mass Privatization Program unless these form part of a business activity.

Based on a Minister of Finance decree of June 29, 1993, services rendered by brokerages offices and trust fund companies are exempt from the value-added tax (VAT).

The Act on Sales Taxes of Shares in Public Trading, dated October 21, 1994, introduced a new tax on the public sale of shares on the secondary market. The tax rate cannot exceed 0.3 percent of the transaction value. In December 1995, the rate was lowered to 0.2 percent. The tax is withheld at the source by a brokerage office.

Taxation of mutual funds and income from mutual funds

According to Polish law, mutual funds do not pay income taxes on income from capital gains, interests, dividends. Income received from foreign securities and mutual funds may be subject to taxation according to the tax laws of those foreign countries involved.

Individuals who redeem participation units of mutual funds are not taxed on that income when the redemption takes place by the end of 1996.

Corporations who redeem participation units of mutual funds are taxed on that income. It is added to income from other sources and taxed accordingly. The tax rate is 40 percent

Taxation of a securities' issue

Since only legal entities may issue securities, the rules of their taxation are described in the Corporate Income Tax Act. Capital received from the issue of stocks or bonds is not treated as revenue and therefore not taxed.

The issue of stocks is subject to a duty stamp charge, based on the value of the share capital when stock is issued by a newly formed joint stock company or the value of the issue of new shares if a company increasing its share capital.

The most recent duty stamp charges are based on a Ministry of Finance Ordinance, dated December 9, 1994, and are as follows:

- up to PLN 10,000 -- 2 percent,
- PLN 10,000 to PLN 20,000 -- PLN 200 + 1 percent of excess over PLN 10,000,
- PLN 20,000 to PLN 30,000 -- PLN 300 + 0.5 percent of excess over PLN 20,000,
- above PLN 30,000 -- PLN 350 + 0.1 percent of excess over PLN 30,000.

Other situations

Reorganizations

The tax system does not currently include specific provisions regarding reorganization. However, this is expected to be addressed in the near future.

Incorporation

If a foreign entity wants to transform its business from a representative office in Poland into a limited liability or joint-stock company, then the two entities are treated as separate and taxed accordingly. Corporate income tax must be paid on the attributable profits of the representative office in the year in which it is closed, to the date of closure. The new company is liable for taxes on its profits from the commencement of its activities. No additional taxes are levied on this type of transaction other than the normal notary fees and duty stamp charges payable during the formation of the new company.

Merger

Mergers by legal forms of Polish business entities are allowed under the Commercial Code. Companies may merge by assigning shares in the acquiring company to the shareholders in the transferring company, or by creating a new joint-stock company into which the assets of the merging companies are placed in exchange for shares in the newly formed company.

The company resulting from a merger is taxed at the 40 percent rate according to the Corporate Income Tax Act. No special taxes are in place regarding the merger process, although duty stamp charges may be applicable in specific circumstances.

Liquidation

A liquidated company has to pay all taxes and obligations to the Government and creditors before distributing dividends to its shareholders. All profits arising to the company during liquidation are taxed at the standard corporate income tax rate of 40 percent.

Initial contributions transferred by a company back to its shareholders during liquidation proceedings are not regarded as taxable income to the shareholder, but any sum over these amounts is taxable.

4.4. Personal Income Tax

The Personal Income Tax Act of July 26, 1991, describes the principles for taxing income earned by natural persons. Natural persons who either live or spend more than 183 days in the tax year in Poland are subject to personal income tax on all income regardless of whether it was earned in Poland or abroad. Natural persons who spend less than 183 days in the tax year or work for foreign corporations or joint-venture companies in Poland pay personal income tax only on incomes earned in Poland.

Income is defined as a surplus of revenues over expenses. The law includes more than 40 subjective deductions.

In 1995, the basic level of personal income tax was set at 21 percent of taxable income. Annual income above PLN 12,400 is taxed at 33 percent, and annual income above PLN 24,800 is taxed at a rate of 45 percent. Foreigners are taxed at a flat rate of 20 percent.

Dividends

All individuals must pay income tax on dividends. However, the tax rate of 20 percent is withheld by the company paying the dividend. Therefore, revenue from dividends is not included on a personal income tax form.

For taxpayers who live abroad, the tax rate on dividends is less than 20 percent if a double-taxation treaty exists between Poland and the country concerned. The tax is usually limited to 15 percent. As a rule, when an investor holds at least 25 percent of the equity of a company, dividend taxation cannot exceed 5 percent.

Interest

Interest earned on Treasury bonds and bank accounts is not taxable.

Interest on other securities and loans is taxed at a 20 percent rate. Because the tax is withheld by the payor, this interest income is not shown on a personal income tax form.

If bank accounts are opened in connection with business activities or lending is a part of these business activities, interest on bank accounts and loans is taxable. It is added to income from other sources and taxed accordingly.

A taxpayer who lives in a country with which Poland has a double-taxation agreement usually does not pay personal income tax in Poland. When the agreement provides that a tax is to be collected at the source, as a rule the amount is limited to 10 percent of the gross amount due.

Capital Gains

Based on a December 13, 1995, decree of the Ministry of Finance, capital gains from a sale of stocks in public trading and Treasury bonds are not taxable until the end of 1996, unless the sale forms part of a business activity.

Normally capital gains are added to other income sources and taxed at the appropriate personal income tax rate.

4.5. Double Tax Relief

The normal method of giving double-tax relief in Poland is to allow a foreign tax as a credit against a Polish tax liability. The Polish taxpayer may not claim a deduction by recording the income received net of foreign withholding taxes as an alternative to the credit method.

Poland holds double-taxation treaties with the following countries:

Austria	France	Canada	Switzerland	Italy
Belgium	Spain	Malaysia	Sweden	Greece
China	Holland	Norway	Thailand	Bulgaria
Czech Republic	India	Pakistan	United States	Mongolia
Denmark	Japan	Germany	Hungary	Romania
Finland	Ex Yugoslavia	Sri Lanka	United Kingdom	Russia

4.6. Conclusions

In our opinion the Polish tax system has many advantages for investors including;

- Exemption from stock transaction taxes and duty stamp charges,
- Tax exemption and reduction in income taxes for investors (both individuals and corporations),
- Low rate stamp charges for shares issued in order to raise share capital,
- Tax exemption for mutual funds.

The disadvantages are:

- Frequent changes in taxation rules,
- Unclear taxation acts,
- Exemption and reduction in some taxes only for a short, defined time,
- No difference in taxation of incomes from long-term investments and speculative investments.

Recently the Minister of Finance promised not to change the taxation rules between 1997 and 2000. This will provide stability and "relief" from the frequent changes of the past.

5. ACCOUNTING AND AUDIT

The advent of the market economy necessarily has changed the rules and regulations related to financial reporting and accounting. Joint ventures with foreign partners, companies with shares traded on a stock exchange, dynamic growth in new business start-ups and other new phenomena have affected how Polish companies account for and report on their income. The influx of foreign accountants along with foreign companies as well as Poland's desire to join the European Union in the near future also are having an impact. The result was the Accounting Act of 1994 which specifies accounting rules and procedures for audit of financial statements by certified auditors.

The Accounting Act and the standards it defines are based on the European Union's 4th and 7th Directives, which are generally in accordance with International Accounting Standards (IAS). The provisions of the Accounting Act apply to:

- Companies, individuals and partnerships if their net sales of goods for resale and finished products plus financial income exceeds the zloty equivalent of ECU 400,000 in the previous year (the State Treasury and National Bank of Poland are excluded);
- Organizations operating under the Banking Law, Law on Public Trading in Securities and on Trust Funds or under insurance regulations;
- State or communal budget entities;
- Foreign legal persons or foreign entities which aren't legal persons but with operate in Poland personally, through a representative, with employees;
- Entities which receive subsidies, state or commune aid, special projects or earmarked funds.

5.1. Accounting/Audit Profession

The Krajowa Izba Biegłych Rewidentów (National Chamber of Auditors) is the auditors' professional association. It was founded in 1991 in accordance with the Examination and Disclosure of Financial Reports and Auditors and their Self-government Act.

To become a certified auditor, one must have a master's degree, be a Polish citizen, have at least two years experience in an auditing firm and pass a series of examinations ranging from financial analysis to accounting methods to computer usage. The National Chamber of Auditors supervises this process. Foreign nationals with equivalent qualifications (e.g., a CPA from the US) can also become a certified auditor in Poland. To prove their knowledge of Polish law and taxes, they must pass an examination in Polish.

The Polish Accountants Association is the professional body for chartered accountants. It was re-established in 1957. Although no specific education is required of accountants, many have university degrees in economics.

5.2 Audit and Accounting Firms

All of the Big Six have opened offices in Warsaw -- Price Waterhouse, Arthur Andersen, Ernst & Young, Deloitte & Touche, Coopers & Lybrand and KPMG Peat Marwick -- following the migration of their multi-national clients investing in the new economy. They combine the expertise of their expatriate staffs with local accountants and transfer of skills is an integral part of their operations. They work primarily with large Polish companies seeking foreign capital, companies in the National Investment Funds and their multi-national clients which have offices in Poland or the region.

5.3 Audited Financial Statements

Those entities subject to the Accounting Act (listed previously in the section introduction) are required to produce:

- Balance sheet,
- Profit-and-loss statement,
- Notes to the financial statements.

Joint-stock companies, banks and insurers, companies operating under the Law on Public Trading and on Trust Funds as well as those meeting income and employee thresholds must produce audited financial statements (balance sheet, profit-and-loss and cash flow, along with notes). The required reports are prepared as of the date the books are closed for the year.

In addition, annual financial statements must be accompanied by a directors' report. In limited-liability and joint-stock companies the Management Board prepares the director's report. It should comment on significant events, expected development of the company, major research and technological achievements, and current and expected financial standing of the company.

Financial statements must be filed within five to nine months of the balance sheet date at the latest and be filed with the appropriate authorities; the time depends on the type of company. Limited-liability companies, joint-stock companies, cooperatives and mutual insurance companies must make their financial statements available to shareholders or members at least 15 days before the annual meeting.

The Act describes in detail how each financial report and the notes and director's report are to be presented. It provides copies of the required formats for the various reports. The Act also describes in detail how a company's bookkeeping should be organized. Accounts and financial statements are to be drawn up in Polish and in Polish currency.

Audit and Publication

The objective of an audit is to present a written opinion by a certified auditor and an auditor's report on whether the financial statements meet relevant legal requirements and give a fair and clear picture of the company's property and finances. If a qualified opinion, disclaimer or adverse opinion is given, the auditor must state clearly the reasons for this.

Audits must be completed by certified auditors who can provide impartial and independent opinions. The auditor must have access to the company's financial records and the right to obtain other relevant information.

Audit and publication of financial statements applies to the following:

- Banks and insurers,
- Entities which operate under the Law on Public Trading of Securities and on Trust Funds,
- Joint-stock companies,
- Other entities which meet or exceed two of the following in the previous year:
 1. Annual average employment of 50,
 2. Total year-end assets of zloty equivalent of ECU 1,000,000,
 3. Net sales of goods for resale and finished products plus dividends and interest income of zloty equivalent of ECU 3,000,000.

The entity's director is responsible for filing financial statements and the auditor's opinion with the court or other body which maintains a register of records of the entity. In addition, publication of the statements must be made in the publication *Monitor Polski B* within 15 days of their approval.

6. DERIVATIVE INSTRUMENTS AND POLISH CAPITAL MARKETS

6.1. Money Market Derivative Instruments

Forward transactions

Currently, some commercial banks, including Bank Śląski SA, BRE SA, Polski Bank Rozwoju SA (PBR SA), Kredyt Bank SA, and foreign banks provide currency forward transactions as exchange-risk insurance for export/import enterprises. This is a first step. We can expect to see this currency instrument in wider use among bank clients in the near future as the understanding of its use expands.

For example, the Polish Development Bank (PBR SA) offers forward transactions of \$50,000 or the equivalent in another currency. Forward contracts are closed for periods up to three months, although this term is negotiable. The basis for entry into forward contracts is documented proof of the existence of payment obligation in a foreign currency.

This bank also offers other foreign exchange transaction currency-risk hedging:

- Cash settlement
Quasi-sale/purchase of currency to be undertaken on a specific date in the future (agreed at the signing of the contract) at a pre-agreed rate of exchange. Cash settlement transactions do not involve actual delivery and receipt of currency, only settlement in zlotys of the difference between the actual rate of exchange and the contracted rate. The bank requires a guarantee deposit in zloty of 10 percent of the contract amount.
- Swap
Selling or purchasing of foreign currency for zlotys or foreign currency, with the parties obligated to purchase or sell the same amount of foreign currency before the agreed deadline at an indicated exchange rate.

The minimum amount for both of the above-mentioned transactions is \$50,000 or the equivalent in another currency¹

Because of the wide spreads and limited liquidity, these instruments have no real speculative use or character.

Futures

At this time only PBR SA offers an interest-rate option. The bank offers one-month interest-rate options based on the WIBOR (zlotys) (Warsaw Interbank) and three-month interest-rate options based on the LIBOR (US dollars and German marks). The bank has some conditions and limits for these transactions. The customer must choose between three interest rates and can choose only one date from three to declare an option. Option prices are published by newspapers such as "Nowa Europa" and "Rzeczpospolita". PBR SA also can buy put options. In this case, the collateral against insolvency of the customer is

¹ Source: Polish Development Bank „Perspectives and Profile”

a guarantee deposit amounting to 5 percent of the nominal value of the selling options. A guarantee deposit bears interest like regular bank deposit.

The National Bank of Poland (NBP) has prepared new regulations concerning banking financial statements to better control risk connected with derivative instruments. Beginning this year, the regulation was implemented. In 1996, banking statements received by the NBP will include, apart from forward transactions, options and other derivative transactions.

A new draft of the Polish banking law is expected to include a special section obligating banks to balance the risk involved with derivative instruments. According to many specialists, these regulations are insufficient. Transactions on interbank markets are always dangerous. Therefore, a futures exchange is needed (this project is being carried out by the Polish Banking Association) as well as a clearing house.

6.2 Capital Market Instruments

Options

PBR SA was also the first bank to attempt to introduce option contracts based on capital market instruments. This was a derivative product called "a futures contract on the WIG". This, however, was short lived.

PBR SA offered one- and three-month call options on the WIG index price, respectively at PLN 522 and PLN 1108 for the WIG value of 9000 points. The "calls" for the WIG value of 9500 points were valued at PLN 317 and PLN 874, respectively. In the contract, the bank committed to pay PLN 1 per one point of the WIG Index above the assumed values on a given date. At that time, the value of the WIG index reached 8805.1.

As a rule, the Polish Securities Commission (PSC) does not oppose derivatives. The Polish Securities Law gives the Chairman of the Commission the right to regulate the form of trading in derivatives. In the PSC's opinion the most logical solution is to regulate first, then to list a product. The PSC wants all derivatives to trade on the WSE. The PSC is preparing detailed regulations concerning derivative instruments.

In July 1994, a report titled "Warsaw Stock Exchange 1999" was prepared by SBF-Bourse de Paris at the request of the WSE. This report included recommendations related to derivative instruments.

Experts have provided guidelines on how to create and supervise the derivatives market on the WSE. According to French experts, it is too early to organize a normal options/futures market at the present stage of the WSE development for the following reasons:

- Relatively high level of fluctuations of quoted shares,
- Low liquidity of shares,
- Insufficient experience among investors,
- High level of risk related to the organization of the options market,
- Too few potential investors, such as large institutional investors and trust funds.

Additionally the option/future market requires sophisticated and expensive equipment and knowledge (on-line computer systems, clearing house).

The French have proposed establishing a kind of options market with the following conditions:

- New market should not be risky for WSE (only register process, without quotation, clearing and guarantee),
- Minimal cost to WSE (non-automatic procedures, standard clearing procedure),
- Minimal risk to investors (only professional participants, without swap contracts),
- Block market only (minimum number of contracts is determined).

Considering these conditions, the Warsaw Stock Exchange management sees no possibility or need in the near future (one to two years) for an options market in WSE equities. (The only futures transactions conducted on the WSE have been trading in subscription rights since February 1994.)

Probably the first derivative instrument will be warrants. Warrants are the same as subscription rights but with longer maturities (one or two years). In many markets these instruments precede the formal opening of derivative markets. It will be an "acid test" of the willingness of the Polish market to start trading in derivatives.

Institutional Infrastructure for Derivatives

Derivatives would require the creation of a new clearing house or enhancement of a current institution (National Depository of Securities) to assume this role. This institution would function as a guarantor, facilitating an active secondary market in listed options. (A guarantor effectively places itself between the buyer and the seller in each option trade.) Conversely, every option writer is obligated to this clearing institution for performance under the contract. The obligation of each writer to the clearing institution is guaranteed by the securities firm, or clearing member, who maintains the writer's account.

This clearing member guarantee is the first line of defense in a system of safeguards. The clearing institution effectively assumes some credit risk with respect to each clearing member. In turn, the clearing institution manages this credit risk by:

- Subjecting each clearing member applicant to a thorough initial credit review and requiring that the applicant meet defined standards of financial responsibility,
- Securing and maintaining complete credit documentation,
- Conducting routine, rigorous assessments of each clearing member's creditworthiness.

Each of these conditions requires regulations, trained personnel and procedures which are currently non-existent in Poland.

The terms and conditions of each contract should be defined by the clearing institution's by-laws and rules. For example, in the event of a tender offer or corporate reorganization, the clearing institution adjusts the terms of each contract.

The clearing institution, ultimately, also acts as the transaction "processor". This means that the clearing institution:

- Receives matched trade inputs from the participant exchange,
- Receives post-trade input from clearing members,
- Receives and processes margin deposits or withdrawal activity from clearing members.

Clearing institutions also are responsible for updating clearing members' prior position balances with each trading day activity, assigning exercise notices to clearing members who have open short positions, and communicating the results of each process to clearing members, banks and the exchange.

The National Depository of Securities is the institution most likely to assume such a position in any anticipated derivatives market.

7. COMMERCIAL CODE

When the core of the Polish Commercial Code was developed in the 1920s and 1930s, it was among the most progressive bodies of law in Europe. During the 40 years of a planned economic system, this law lay dormant. They existed but could not be adjusted to the post-war economic system. Therefore, much of this law is still "on the books" -- as the Commercial Code of 1934. Needless to say, it's not so modern anymore, especially in comparison to Western Europe or the United States. But it is still capable of providing the necessary base for a market economy. However, the Commercial Code still governs the formation and operations of private companies in Poland. In addition, the Joint Ventures Act of June 14, 1991, clarifies the manner in which foreign firms may invest in Poland.

A serious reform of Polish commercial law is needed. Poland's desire to become a part of the European Union may stimulate this. The nation's commercial law doesn't meet EU standards at this time.

The Polish 'hierarchy of companies' is necessarily different from that in the US (sole proprietorship, partnership, incorporation). Most Polish business people form joint-stock or limited-liability companies. However, sole proprietorships and partnerships are provided for under both the Commercial and the Civil Codes. A civil partnership is the simplest form and requires at least two partners. A limited partnership under the Commercial Code, however, is more like a US sole proprietorship since it provides for a one-person partnership.

7.1. Joint-Stock Company

Formation procedures

The first of two forms which allows foreign participation is the spółka akcyjna (SA) or joint-stock company. The application for company entry into the Commercial Register must be submitted to the Registry Court. The majority of joint stock companies in Poland are medium- to large-sized firms with a large number of participants, state-owned companies, insurance companies or banks. A joint-stock company has an individual legal status that is separate from those of its founders and shareholders. The company charter of a joint-stock company must take the form of a notarial deed. A minimum of three founders must sign the notarial deed unless the founder of the company is the state or a local authority. The notarial deed should include provisions concerning the number and type of instruments that entitle the holder to participate in profits or in a division of company assets, along with the rights associated with these instruments; any additional obligations connected with the purchase of the shares; and the conditions and manner in which the shares can be canceled. In addition, the notarial deed should identify the persons owning the shares; the number and type of shares owned by each; the issue price; and the amount, place and dates of payments that must be made prior to company registration. It also should confirm that the company's governing bodies have been elected.

A joint-stock company may be founded either through public subscription or by the founders retaining 100 percent of the stock themselves. These are discussed more fully in Part 3, Section 2 -- "Raising capital and funds on capital markets."

Capital structure

The minimum capital required to establish a joint-stock company is PLN 100,000 (about \$40,000). The share capital of a joint-stock company may be paid in cash or through in-kind contributions, or by some combination of the two - except when the share capital is raised through public subscription. Twenty-five percent of the company's capital is required to be paid before registration, except when the capital requirement is met via an in-kind contribution. Full payment must be made in this situation, and a certified valuation must be provided before a company with in-kind contributions may be registered. The company may be 100 percent foreign-owned, and Polish law provides for establishment of a three-person joint-stock company.

Shareholders of a joint-stock company have limited liability with regard to the company's obligations. The types of shares include registered and bearer shares, and both ordinary and preferential shares may be issued. Issues such as voting rights, dividend payments and profit distribution upon liquidation, among others, must be clarified in the company charter.

Capital increases may be financed by offering new shares provided a resolution has been passed at a general meeting of shareholders. Unless a provision of the company charter or the resolution states otherwise, existing shareholders have priority in acquiring new shares in proportions equivalent to their current level of share ownership. Share capital may be decreased by reducing the nominal value of the shares or through cancellation of a portion of the shares. Notification of an increase or decrease in share capital must be submitted to the Registry Court for entry into the Commercial Register.

Shares are fully transferable, but the company's charter may make the transfer of the shares subject to permission of the company, or may restrict it in another way. The transfer of registered shares may be done through a written declaration and handing in the shares. All subsequent public offerings of shares are required to obtain consent from the Securities Council.

Relationship of shareholders, directors and officers

A Management Board is composed of one or more members who are the legal officers of the company. They represent the company both in and out of court and have responsibility for managing all commercial activities of the company, except in matters which require a general meeting resolution. The manner in which the company is to be represented should be documented in the company charter. If a joint-stock company has a share capital in excess of PLN 500,000, it should have a Supervisory Board too. Additionally, an audit commission may be established if shareholders representing one-fifth of the share capital mandate this.

The Supervisory Board (board of directors) should have a minimum of five members. The initial term of office is one year. This body functions much like a US board of directors. It supervises the company's activities in all aspects of its business. Its members examine the financial statements and review Management Board reports and motions dealing with profit distribution and loss coverage. The Supervisory Board may suspend members of the Management Board if necessary, and the scope of the Supervisory Board's responsibilities may be extended in the company charter.

The Audit Commission performs the same activities as the Supervisory Board, and these two groups work together to supervise the company's activities. The Audit Commission presents a written report of its findings at a general meeting, and supervisory resolutions are passed by a majority vote unless the company charter provides otherwise.

A general meeting, convened by the Management Board, is held within four months of the end of each financial year. Ordinary general meetings consider and approve the audit report, balance sheet and profit-and-loss account for the preceding year, adopt a resolution on the distribution of profits or how to cover losses, and confirm the performance of all duties entrusted to company officials. At least three weeks before the meeting date an announcement of the meeting must be placed in a national newspaper devoted to company notices. All registered shareholders may participate, provided they are registered in the share register at least one week before the general meeting is to be held. Bearer shareholders may participate too. However, because of the nature of their shares (bearer), they must register their shares with the company at least one week before the meeting date and may not withdraw them before the end of the general meeting.

Ordinary shareholders are granted one vote for each share they hold and may vote by proxy as long as the proxy is granted in writing. Generally voting is open. Secret ballots are used in elections and motions for removal of members of the company bodies or liquidators calling an individual or individuals into account as well as in personnel matters. A shareholder also may request a secret ballot.

Liquidation

A company may be liquidated by reasons stated in its charter, by a general meeting resolution or by insolvency. A three-quarters majority of votes cast during a general meeting is necessary to dissolve a company, unless the company charter provides otherwise. An announcement stating that liquidation has commenced must be made in newspapers devoted to company notices, and this announcement should call upon creditors to present their claims against the company.

Dividends will not be paid to shareholders until all company obligations have been satisfied. If company assets cannot cover the amount owed to preferred shareholders and ordinary shares are not paid in full, further payments must be subscribed by ordinary shareholders. Any remaining profits may not be distributed until one year after the date of the final liquidation announcement. These are divided in proportion to each shareholder's payment in share capital. In the event of a company's insolvency, liquidation may not proceed until bankruptcy proceedings have concluded.

7.2. Limited-Liability Company

The second of the two forms allowing foreign participation is a limited-liability company (*spółka z ograniczoną odpowiedzialnością - Sp. z o.o.*). This is the most common form of business enterprise that foreign firms establish in Poland. The company must satisfy the permit requirements for joint ventures if foreign participation is involved. Limited-liability companies are typically small- to medium-sized businesses with a small number of participants and may be wholly-owned by one person.

A limited-liability company has an individual legal status that is separate from those of its founders and shareholders. The articles of association of a limited-liability company must be in the form of a notarial deed. In addition, the notarial deed should include provisions concerning in-kind contributions that fulfill the minimum capital requirements and stipulations that cover additional shareholder benefits or obligations. Then the Management Board of the Polish company should submit a completed application to the Registry Court to register the company.

Capital structure

The minimum capital required to establish a limited-liability company is PLN 4,000. This capital must be paid in full before the company can be registered. Non-monetary contributions may be made as long as they are in accordance with the Commercial Code. A company may be 100 percent foreign owned, and Polish law provides for the establishment of a one-person limited-liability company. Share ownership is registered. Shares must be transferred by written contract, unless there are additional restrictions in the notarial deed.

An increase in capital is allowed by a general resolution at a meeting of shareholders. To decrease in capital, a majority resolution must be passed at a shareholders' meeting, followed by a notarial amendment to the original founding deed. As with the joint-stock company, shareholders have limited liability in this type of business enterprise.

Relationship between shareholders, directors and officers

The company's governing body is the Management Board. These are like the officers of a US corporation. Members of this board must be appointed by a shareholders' resolution unless the notarial deed states otherwise. The members represent the company in all areas connected with the business enterprise.

Shareholders have the right to supervise the Management Board by examining the company's books and documents, drawing up a balance sheet for their own use and demanding explanations from the Management Board about specific issues. However, the notarial deed may establish instead a Supervisory Board (like a US board of directors) or an Audit Commission or both to supervise management, and this action relieves shareholders of this right. These bodies have the authority to review every aspect of the company's activities, and at least one of the two should be established when a company has both a share capital of more than PLN 25,000 and more than 50 shareholders.

Ordinary shareholders' meetings are held within six months of the end of each financial year, and extraordinary meetings are convened when the governing bodies or persons authorized to convene such meetings deem it necessary. Shareholders may participate in the meetings, and resolutions are passed by a majority of the votes cast. Resolutions concerning amendments to the notarial deed must be passed by a two-thirds majority of the votes cast. Unless the notarial deed states otherwise, each PLN 10 worth of shares carries one vote, but each shareholder has at least one vote. Voting is open, with secret ballots used for elections and by request of a shareholder.

Liquidation

The company may be liquidated for a number of reasons, including those listed in its notarial deed. The dissolution of a company also may occur following a shareholders' resolution at a general meeting or due to a company's insolvency. The profits received from the sale of assets may not be distributed to the shareholders until all obligations have been satisfied. These profits are to be distributed pro-rata, according to the shareholdings of individual owners, unless the notarial deed provides otherwise.

7.3. Transformations of Joint-Stock and Limited-Liability Companies

A joint-stock company may be transformed into a limited-liability company and vice versa. Unless the company charter states otherwise, the presence of enough shareholders to represent at least one-half of the share capital and a three-quarters' majority vote of these shareholders is required to pass a resolution transforming the company. The resolution should define the values for the shares of the joint-stock company and include a draft of the limited-liability company's deed of association. The resolution is not binding until it has been registered, regardless of when voting occurred.

Certain conditions must be fulfilled before the registration application process starts. Shareholders in a joint-stock company who wish to join a limited-liability company must hold at least two-thirds of the total nominal value of the share capital of that company. If the total share capital of the limited-liability company is not paid in full by the applicants, then the limited-liability company's share capital must be supplemented with new shares that make up the difference. These shares must be paid for in cash. Then shareholders in the joint-stock company will acquire shares in the new company equivalent in value to their shareholdings.

Once these conditions have been met, the transformation of the joint-stock company into a limited-liability company (or vice versa) must be reported to the Registry Court for entry into the Commercial Register by the Management Boards of both companies, including the appropriate changes. The transformation becomes effective once the entry is made in the Commercial Register; the relevant ministries should be notified within two weeks of the change. Shareholders who do not support the transformation may be paid the value of their shares as defined by the transformation resolution.

7.4. Registered Partnership

Because business people and companies generally form a Polish legal entity rather than enter into a registered partnership, a registered partnership (*spółka jawna*) is rarely used. An application for entry of the partnership into the Commercial Register must be submitted to the Registry Court. The partners have unlimited liability, and the partnership is not a "legal person". Partners would choose this form of entity if they had more complex business activities than those that may be performed by civil partnerships.

7.5. Limited Partnership

A limited partnership (spółka komandytowa), which is a specific form of a registered partnership, is the third type of partnership. One partner (or partners) is responsible for the management of the partnership and has unlimited liability. The other partner or partners have limited liability and are liable only to the extent of their capital contributions. A limited partnership is also not a Polish legal person. This type of partnership possible only since November 5, 1991, is still relatively rare.

7.6. Joint Ventures Act

The Joint Ventures Act of June 14, 1991, which came into effect on July 4, 1991, replaced the Foreign Participation Act of December 28, 1989. The Joint Ventures Act governs the establishment of a joint venture with foreign participation in Poland. All companies with foreign participation are subject to the provisions of this Act, including those companies that previously qualified for a tax holiday under the 1989 Act. These companies may, however, continue to enjoy the tax holiday until their permit expires. This is the only area where companies established prior to July 4, 1991, may deviate from the Joint Ventures Act.

A joint venture must be organized either as a limited-liability company or a joint-stock company operating in Poland according to the provisions of the Commercial Code. Special considerations apply to acquisitions of or participation in State-owned enterprises, but in principle all types of business are open to foreign investment.

The Minister of Ownership Changes or the other relevant Minister, the central administrative authority on foreign investments, is responsible for all decisions concerning the formation of companies and the issue of permits. Companies formed under Polish law, even if 100 percent owned by foreign investors, are Polish legal persons to which Polish law applies. The rules and regulations involving the formation of a business entity in Poland are stringent and must be strictly followed to avoid delays. In the application process they should be regarded as a prerequisite to doing business in Poland.

Permit requirements

Companies that propose to form Polish subsidiaries or to participate in existing Polish companies should consult their professional advisers to determine whether their proposed activities are subject to a permit requirement from the Ministry of Ownership Changes or some other body. Similar considerations apply if an existing company wants to form or acquire a Polish subsidiary. A company is trading illegally if it fails to do this.

The establishment of a joint-venture company with foreign participation requires a permit if:

- Its business activity includes one of the following:
 - a) Management of seaports and airports,
 - b) Real estate agency sales and services,
 - c) Defense industry not subject to a licensing requirement ,
 - d) Wholesale trade in imported consumer goods,
 - e) Legal advisory services.

- A state-owned enterprise (apart from a company where the State Treasury has 100 percent of the shares) is to make an in-kind contribution constituting of an integral part of itself.

A company also is required to obtain a permit if required by other regulations (e.g., if a state-owned enterprise leases its property to the joint-venture company for a period of more than six months). The permit application is made to the Ministry of Privatization, and no further steps are necessary until the permit is granted, although preparatory work for the formation of a company may proceed. The permits usually are issued without difficulty, unless a problem arises due to the incorrect completion of the application. All documentation required for the formation of a company must be written in or translated into Polish. Documents that originate outside Poland must be certified by Polish consular officials in the country of origin as meeting the laws of that country.

7.7. Civil Code

The civil law is the fundamental branch of the law regulating property relations between legal subjects of equal status as well as protection of personal goods. Civil law regulates relations between natural persons, between legal persons and between natural and legal persons.

The basic normative act of civil law is the Civil Code of April 23, 1964, with subsequent amendments, and particularly the amendment of July 28, 1990, concerning securities.

The Civil Code is based on the fundamental principle of the unity of civil law. The Polish legal system does not have separate provisions for economic law and commercial law. All property relationships between subjects of equal rank, regardless of whether they are of a profit or non-profit nature, are the subject to civil law. Civil Code solutions are derived from the following basic principles:

- Equal status of subjects regardless of the form of ownership they represent,
- Equal status of services -- performance of one party corresponds subjectively with performance of the other party,
- No limitations of contracts.

The Civil Code consists of four books, including the following sections:

1. General definitions including legal status, legal capacity and capacity to perform legal transactions, conclusion of contracts, submission of declaration of will representation and statutes of limitations,
2. Property and other property laws, including the concept and protection of the right of ownership, acquisition and loss of such rights and limited property rights,
3. Obligations, a definition of the concept and types of obligations, contractual and the fulfillment and expire of obligations. A specific chapter of this section on obligations defines standards, terms, kinds of contracts.
4. Inheritance, including intestate issues and testamentary succession, wills.

The Civil Code is the basic but not the only legal regulation of civil law. This branch of law also is composed of many detailed laws such as the Mining Law, Marine Law, etc. When applying these diversified legal acts, the Roman principle prevails: Detailed regulation takes priority in application before general regulation.

The Act of 1964 has been amended and updated numerous times so that its solutions are adjusted to modern regulations in trade and to European models and standards.

Civil Partnership

The simplest form of business operations in Poland is a civil partnership (*spółka cywilna*), which is based on a contract agreement between two or more partners. A partnership is not a Polish legal person. For tax purposes, it is regarded as a transparent conduit in which the partners are taxed in their respective shares of income. A foreign person or corporation may not participate directly in a Polish partnership. Foreign investors generally form a Polish joint-stock company or limited-liability company, which, as a Polish legal person, can then enter into a partnership agreement.

A civil partnership only has to be registered in its local administration office. It is not a Polish legal person and has no capital requirements or restrictions. The partners have unlimited liability and must follow the rules of the Civil Code. This partnership form is most widely used in Poland and is the simplest type to establish.

8. PENSION FUND LEGAL REQUIREMENTS

The current social security system "pay-as-you-go" -- younger generations directly finance retirement pensions of the elderly. This inter-generation transfer is not fully funded since current contributions finance current pay-out liabilities without long-term capitalization. The process is centralized and fully supervised by the State-owned Society Insurance Institution (Zakład Ubezpieczeń Społecznych -- ZUS). Currently there are no records of individual contributions and no customized accounting shows past pay-in history.

The Government of Poland has recognized the need to develop a robust pension fund industry as soon as possible. The initial, primary responsibility lies with the Ministry of Finance which already has drafted a proposal on a tax-deferral system for pension fund participants.

8.1. Reform of Social Security Systems -- Pension Funds, Retirement Plans

Neither current Polish law nor regulation provides any context for establishing pension funds outside the context of a State-run and supported social security system. A better understanding of the role a supplementary funded system could play in the future of public social security here will be possible only after the extreme weaknesses and deficiencies of the current system, in its actual condition, are exposed to the public and acknowledged by Parliament. This already has been acknowledged by the Council of Ministers.

The Polish social security system is in a deep financial crisis as the population ages and unemployment grows. The existing system cannot remain self-financing, and budget subsidies to ZUS must continue to increase to meet the system's cash needs. The social insurance fee has increased from 15.5 percent of salary to 48.2 percent of salary over the last 20 years. Subsidies from the budget increased from 14.4 percent to 21 percent of GNP.

Factors significantly influencing and affecting the crisis include:

- Unfavorable structure of the labor force with a decreasing ratio of active members of the labor force to pensioners (currently about 2:1);
- Significant increase of benefits in relation to wages during past two years, as a result of the inflation-adjusted benefit levels;
- "Real" age of retirement is lower and lower (disability pensions are relatively easy to obtain, early retirement provide unemployed or under-employed individuals with a greater source of income),
- Benefits paid are not linked closely to an individual worker's historic earnings, as payments were increased dramatically to protect pensioners from some of the effects of the extreme inflation that has occurred since the flotation of the zloty,
- Penalties are not sufficiently severe to deter those still working from applying for and receiving a pension even while continuing to work,
- Transition to a market economy has resulted in many factories and other economic enterprises falling into arrears, particularly to the ZUS.

The combination of these factors is forcing Poland to make adjustments to both the benefit and contribution sides of its pension program. The downward slide of this financial crisis will deepen, at least until 2005, mainly as a result of demographic trends.

8.2. Proposed Reforms

A long-term, deep, structural change in the public social security system is needed, especially if pension payments are to be distributed to a growing body of pensioners, who will form a significant voting bloc.

According to the recommendations of the project announced in May 1995, by the Ministry of Labor and Social Policy and subsequently submitted to the Sejm, the reconstituted system should include three pillars:

1. Basic obligatory system, soundly based to ensure that the State's responsibility for the welfare and protection of citizens is fulfilled (perhaps guaranteed by the State similar to ZUS). It requires a complete redesign of the funding, contribution, investment and benefit-payment processes.

Retirees are expected to receive 50 percent of their pensions from this "redistribution system" in which benefits are based on length of service and salary.

2. Additional mandatory system based on the principle of linking benefit payments to the individual employee's historical earnings and contributions into the system. It would be managed privately by a joint-stock company.

This would be a capitalized system, and capital requirements would be set by the government. The performance of the closed-end fund will affect the benefits paid.

3. Separate, voluntary system directed to middle- and upper-income employees who want pension benefits that are higher than those provided through the mandatory pension funds. The portfolio underlying this system presumably would be based on different, and possibly more risky, financial instruments than those in the mandatory systems. The intention here would be to create a structure comparable to the tax-deferred, Qualified Plan pension funds in the USA and Registered Retirement Saving Plans (RRSP) in Canada.

No rules for RRSP performance have been prepared as yet, and it is an issue to be tackled by the Ministry of Labor and Social Policy in the project plan for a new public social security system. Currently a few quasi-pension funds are available in the market, but they are not, by any means, Qualified Plans or RRSPs.

8.3. Conditions for Reform

Several fundamental conditions determine the reform of social security system in Poland:

- The key element is reform of the funding method for the public pension system. This can be accomplished as part of fundamental tax reform and the privatization program.

In the future, the costs of financing the pension system should be spread over both the payroll and value-added tax system. To fund the liability already accrued for current members of the labor force, the State could invest some of the debt and equity of the State-owned firms being privatized.

With new tax legislation, contributions to pension funds or to RRSP could be made tax-deductible subject to limits, and investment income could be sheltered from taxation until the benefits are paid to the individual. By sheltering investment earnings from taxation over a period of many years, the effect of compounding is enhanced significantly. Such rules would encourage individual savings for retirement and allow a reduction in the state's responsibility for pension services. Simultaneously, the currently high ZUS tax rate could be reduced comparably.

- A new public social security system, introduced by the Ministry of Labor and Social Policy, could define the proportion between basic and supplemental elements, the structure of supplementary elements, the State's responsibility for pensions, the methods of financing each element and methods of enforcing a strict adherence to the established age of retirement.
- The method of financing every element of a new pension system must be delineated. At present, the Polish pension system is financed on a pay-as-you-go basis from the proceeds of a pay-roll tax which is more than 48 percent. One alternative is to allow any employee contribution to a pension fund or RRSP as an offset against a payroll tax obligation.

A special Commission was established to coordinate the work of constructing this new system. This Commission's membership should be expanded to include representatives of banks and financial institutions which would by necessity be involved in the future operational aspects of such a new system.

- The Security Act needs to be updated by Parliament as soon as possible, since a lack of enabling legislation makes it impossible for the State to control quasi-pension funds since they are not mutual funds. The Government needs to develop detailed rules for the operation of pension funds. Regulatory control of such pension funds would be provided by the Minister of Labor, the Minister of Finance, and the Chairman of Securities Commission.
- Poland lacks experience in the creation and administration of both pension funds (in the form of closed-end mutual funds) and registered retirement saving programs. Assistance from countries with a solid basis of expertise in this field (such as USA, Canada) will be vital to a speedier process.

- A large interest and even current demand in Poland for immediate improvement of the pension system already exists. However, to ensure success, considerable research needs to be completed on all aspects of the inter-linking of the pension and taxation system.
- ZUS could be allowed to invest contributions (assuming it has assets to invest) in alternative financial instruments, with flexibility to allow for both conservatism of the fund assets while obtaining reasonable investment return. This requires that new tax legislation be prepared by the Ministry of Finance.

Part III.

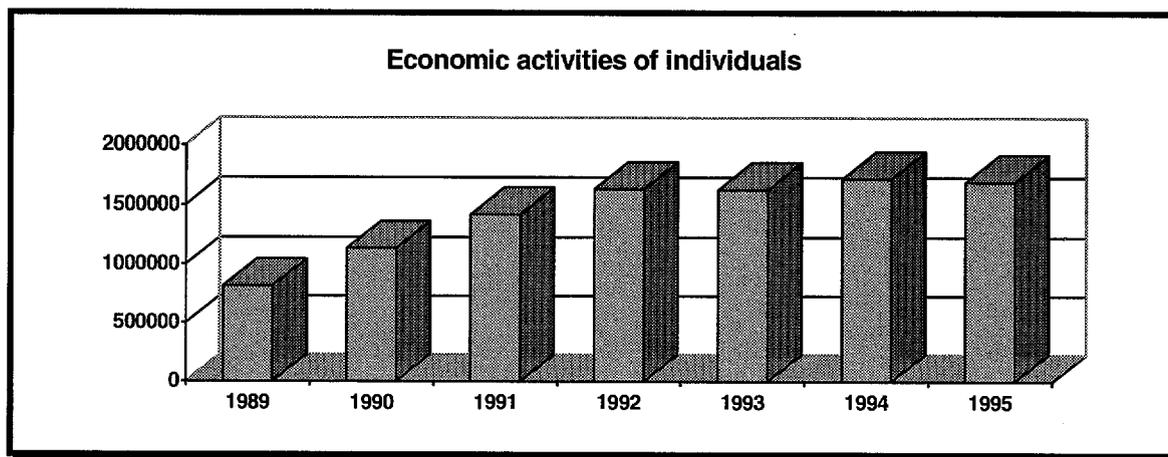
**MARKET PARTICIPATION BY
SMALL- AND MEDIUM-SIZED
ENTERPRISES**

1. CONSTRAINTS FACING MARKET PARTICIPANTS

An entrepreneurial sector existed in Poland even during the Communist era. Entrepreneurs carried out business quietly and with maximum flexibility. They operated almost entirely on a cash basis, developing an aversion to disclosure of information and a distrust of the Government which still continues today. These private businesses were the base from which today's small- and medium-sized enterprise (SME) sector¹⁴ has developed and grown rapidly. Although not all private businesses in Poland can be defined as belonging to the SME sector, a vast majority do. (Most "big business" in Poland is still owned wholly or in part by the State.) Thus the history and interests of private business and SMEs are closely linked.

Small- and medium-sized enterprises in Poland have a limited access to capital. Short-term loans are very expensive, and the collateral requirements are too high. About 90 percent of new companies start their activities without any bank financing. Few companies in the SME sector have the resources to meet the requirements for a public issue of stock on the Warsaw Stock Exchange, and an Over-the-Counter Market does not yet exist (though the latter is under development).

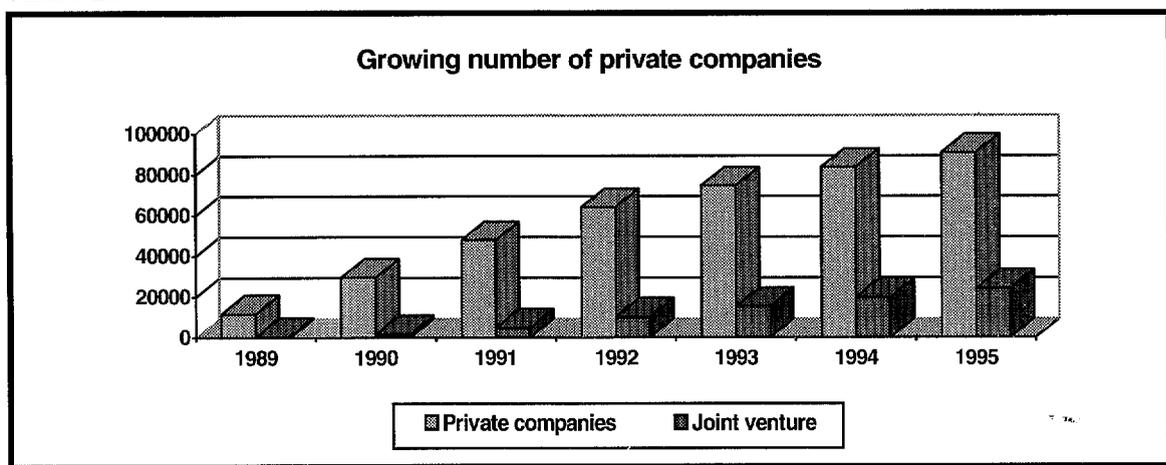
Chart 22



Source: Central Statistical Office report

¹⁴ Unfortunately standard Western indicators such as sales, profits, assets and sales per employee are not used to define the size of enterprises. Rather the number of employees is the criterion used by most organizations, including the Central Statistical Office; a few organizations use no criteria at all. The SME sector is defined as companies with five to 200 employees.

Chart 23



Source: Central Statistical Office report

1.1. General Constraints

In addition to specific constraints to their acquisition of capital, some general issues also affect their ability to acquire necessary capital. These constraints often relate to the private sector's past history. For example, the word "organization" still carries many negative connotations in Poland. That plus the entrepreneur's historical avoidance and mistrust of government may explain the reluctance of business people to form a much-needed pro-private sector lobby.

While entrepreneurs are eager to participate in market-oriented business activities, a gap clearly exists between the willingness and ability of individuals to run their enterprises successfully. In recent years they have learned the importance of creating strategies and business plans. However, they still lack understanding of how to create and implement market planning as a management tool. Although this appears to be changing, these are big constraints for potential borrowers. Banks, a normal first source of external capital, are being very cautious.

And finally, the SME sector still relies heavily on the state-owned enterprise (SOE) sector, both as supplier and as client. As a result, the continuing transformation of the SOE sector places the SME sector in a more vulnerable position, at least temporarily.

1.2. Major Constraints

The following are the major constraints small- and medium-sized enterprises face as they seek capital for growth or expansion. These constraints relate to both financial markets and capital markets. Other, more specific constraints exist for those who might seek access to a public offering. Those are discussed in Section 2 of this part.

Creditworthiness

- **Bank Policy and Access**

In the current economic situation, few firms are likely to be considered good candidates for loan approval. New firms lack credit history, and banks require financial track records. In the absence of this information, banks demand too much collateral. In turn, entrepreneurs respond by avoiding bank credit and using their own valuable money for financing.

The inability of many borrowers to prepare a business plan that will justify the need for funding is a major barrier to lending. Since most SMEs are not aware of what banks require, proposals for funding are often incomplete. But entrepreneurs will say that bank proposals are too detailed and require too much disclosure. They also frequently will say that banks over-reacted to the first signs of loan repayment problems without careful review.

Studies of many businesses show that a high percentage use internal financing for working capital. Bank credit plays a minor role as a source of start-up capital for a new firm, and businesses interviewed were very critical of the management capabilities of the commercial banks. Many firms rely on family loans, mattress money, and internally generated capital. Historically, start-up companies provided their own capital until the company became a proven entity. The real difficulty, however, is when a healthy company is unable to access its financial markets in order to meet its short term working capital needs or expand its operations through capital expenditures which require that the company borrow to leverage itself.

- **Cash-flow problems**

SME's are especially vulnerable to short-term cash-flow shortages. When this happens, banks rarely assist them in restructuring term loans. SMEs are starting to pay attention to covering cash-flow needs and now are including this overall strategic planning.

Regulatory/legal issues

- **Timing of reforms**

The development of commercial, banking and tax laws has not kept up with the speed of political developments. This has restricted the development of private enterprise and SMEs.

- **Legal/regulatory constraints**

Too many opportunities exist for broad interpretation of laws now on the books, and changes have not kept pace with political developments. The legal system has no experience with a free-market system. For example, under the current law related to using real property as collateral for a loan, it is extremely difficult for lenders to collect on such property in case of default.

Lack of training/experience

Many entrepreneurs lack the training and/or experience needed to access bank credit or the capital markets. Their inability to do financial market analysis prevents business people from being able to analyze their financial situations and plan a business strategy - or meet bank credit application requirements. Most entrepreneurs are not familiar with bank credit procedures, which place much importance on good record-keeping. The result is that borrowers do not know how best to present their loan request at a bank.

Lack of infrastructure, information, technology

The SME sector lacks an infrastructure, information and technology. A more reliable telecommunications system also is needed. Retail businesses have not developed a standard distribution system, and inventory management is poor.

Government of Poland drain on credit

The degree to which the banks will be required to finance an increasing budget deficit by investing in Government securities will limit the amount of loan funds available to the credit markets. This in part explains bankers' reluctance to take on higher-risk credit proposals. It is difficult to assess the degree to which Treasury-owned banks are obliged to invest in Government securities.

The need for the Government to borrow from the banks to cover the deficit is a serious issue and is a significant element in current negotiations with the International Monetary Fund. It would appear that the Government's funding requirements are a big burden on the banking sector.

Inflation

Inflation is a critical element in any financial discussion, and it is essential to know how flexible banks are in relation to their willingness to finance SMEs as inflation - and interest rates - continue to fall.

2. RAISING CAPITAL AND FUNDS ON CAPITAL MARKETS

Any enterprise planning development has three basic ways to raise these funds:

- Bank credit,
- Sale of bonds,
- Issuance of stock.

The method selected should be based on an analysis of the costs (both present and future) of raising and servicing the financing.

The most popular form of financing business activity in Poland is through bank loans, even though they are expensive and banks, which become reticent about granting loans, frequently grant less than requested.

The significant growth of the Warsaw Stock Exchange in 1993 stimulated the further development of the young Polish capital market. The bull market encouraged firms to list on the exchange and more and more private companies were able to raise necessary capital.

2.1. Private Placement

Private placement is described by the Securities Law as a proposal to buy shares by:

- Offering shares of a privatized company to its employees,
- Offering shares to less than 300 people.

A joint-stock company may be founded in three different ways: through public subscription; by the founders retaining 100 percent of the stock themselves; or by a direct offer of stock from the company to a potential buyer. If shares are to be sold via public subscription, then the founders must obtain consent from the Securities Commission. They also must deposit a sum with the appropriate district court equal to 1/20th of the share capital. (This deposit serves as security for any claims made against the founders during the period of incorporation and is refundable after the company is officially registered or six months have elapsed without company formation occurring).

2.2. Public Offering

Poland still lacks a capital concentration sufficient to allow any real volume of private placements. Simply, few people have enough money to be interested in investing in private firms.

Admitting securities to public trading allows a company to collect capital from a much broader range of potential stockholders (since there is no limitation to the amount of shareholders). Public offerings in Poland, as in the United States, require that the company

meet special conditions set by the Polish Securities Law, including the preparation of a prospectus. After the public offering, secondary trading is possible. Currently Poland has only one Stock Exchange (the Warsaw Stock Exchange). An Over-the-Counter (OTC) Market is in preparation.

Constraints

The time and cost of a public offering are significant constraints that few in the SME sector can hope to meet. It can take as long as a year to prepare for a stock issuance. Out-of-pocket costs and related constraints include:

- The Polish Securities Commission insists that prospectus' display full information which some companies may feel reluctant to divulge, e.g. market share analysis.
- Writing a prospectus requires audited financial reports and rigorous analysis. The consulting companies are expensive and charge between \$10,000 and \$50,000 to prepare a prospectus.
- The "underwriting" brokerage house responsible for the listing process and handling of IPO charges between \$10,000 and \$50,000.
- The National Depository and the Exchange charge start-up fees that start at \$2,500 combined and can climb to more than \$15,000.
- Continuing costs of being a public company are not small: books must be audited by (usually Western) firms on a regular basis and presented in glossy annual reports that are expensive to prepare. Companies must pay ongoing fees for maintaining quotations and the public disclosure aspect requires public relations, marketing and legal work that most companies find expensive and appallingly revealing.

Perhaps the most important constraint is company's management fear of the loss of control (to the shareholders) and the public exposure "going public" represents. Many medium-sized company managers are simply not prepared to either risk this loss of control or suffer the restrictions of public disclosure.

Advantages of Going Public

- As discussed, the biggest advantage of going public is that capital is raised from a broad group of investors.
- Evaluating the market value of a given enterprise is much easier due to publicly listed securities prices.
- Securities traded on the Stock Exchange are liquid.
- Privatized companies are relieved from certain budget/tax obligations.
- Workers who receive shares in a company frequently work harder and have a greater incentive to care about the financial health of a company. Worker relations are consequently more harmonious.

New Method of Public Offering

The bear market in 1994 and the lower interest among investors has made it harder and harder to persuade investors to purchase new shares which were very often connected with high cost of underwriting. Taking that into consideration, issuers try to ensure the success of their issue by new initiatives. Below we present two initiatives, first used in 1995.

Installments

One of the biggest successes in 1995 was the privatization of Bank Gdański, one of the nine commercial banks formed in 1989 from the former regional operations of the National Bank of Poland.

The aim of the Ministry of Finance was to set the price at a sufficient level to see an increase in the share price on the secondary market and the sale of up to 70 percent, and not less than 51 percent of Bank Gdański shares. One of the markets the government wished to attract (up to 32.9 percent) was the foreign investors who could buy Global Depository Receipts (GDRs).

The novelty of the issue was the possibility for Polish citizens to acquire shares in installments, for up to 1000 shares. The first installment of 60 percent was paid immediately and the second installment payable within 90 days. The Finance Minister believed that this procedure would encourage investors to purchase shares in the bank.

Book-building

During the share issue of Bydgoska Fabryka Kabli, Creditanstalt Securities, the leader of the consortium, has presented the new method of selling shares - book building. This method is used in 80 percent share issues world wide.

In this method the consortium links distribution and guarantee tasks. Additionally the consortium participates in setting share price. Share price is set in three stages. Prices in a specific range are determined in the first stage. Next, the phase-book building is starting. The members of consortium check among their customers if there is demand at a particular price. This phase is directed at institutional investors. Finally, members and the leader of consortium on the ground of book-building determine the final share price. At the same time, the terms of the underwriting agreement are revealed. The advantage of this method is the lower cost of issue than in the traditional method of selling shares.

Part IV.

**FOREIGN FINANCIAL
AND TECHNICAL
ASSISTANCE PROGRAMS**

1. PHARE PROGRAM

The Government of Poland and the then-European Community Commission signed a Framework Agreement for the PHARE (Poland and Hungary; Assistance to Restructuring of Economies) Program in 1989. The European Union (EU) created PHARE to help Central and East European countries restructure their economies into market economies. Under this program Poland received ECU 1.03 billion in 1990-1994 and will receive ECU 1.15 billion over the next five years.

The PHARE Program assists in:

- Restructuring and privatizing companies
- Developing the financial sector
- Developing the private sector
- Labor market and employment issues.

The program offers technical assistance such as training and consulting services as well as grants for specific projects.

Specific PHARE assistance programs include:

- **Enterprise Restructuring, Privatization and Demonopolization**

The main purpose of this program is to support the process of economic reform by providing technical assistance to key institutions which are carrying out the tasks of privatization, demonopolization and restructuring. The program focuses on two institutions:

- * **Ministry of Privatization**

- ⇒ Privatization of large state enterprises and companies belonging to the State Treasury,
 - ⇒ Assistance in the preparation and implementation of the Mass Privatization Program, including: printing Mass Privatization and Recompensation Certificates, training top-management in companies and the National Investment Funds (NIFs), advising on and assisting with marketing campaigns for the NIFs, helping to create an underwriting institution for the issuing of the Universal Share Certificates
 - ⇒ Assistance in the commercialization of state enterprises
 - ⇒ Dissemination of information and promotion of privatization in Poland and abroad
 - ⇒ Participation in the preparation of training for top management companies belonging to the State Treasury and personnel of the Ministry of Privatization
 - ⇒ Assistance in selecting and financing consultants for the Ministry of Privatization

- * **State Foreign Investment Agency**

- ⇒ Promotion of investment opportunities in Poland
 - ⇒ Training for personnel of the State Foreign Investment Agency

- **Development of the Financial Sector in Poland**

The main task of the Program is to provide assistance to Polish authorities in their efforts to implement system-wide reforms in the financial sector. Reforms will take place in the following:

- ⇒ Banking,
- ⇒ Insurance,
- ⇒ Accounting
- ⇒ Taxes,
- ⇒ State budget department
- ⇒ Private banking sector

The following specific assistance is directed to the Polish Securities Commission (PSC):

- ⇒ Informational campaign on capital markets
- ⇒ Learning about capital markets in schools
- ⇒ Translation of textbooks
- ⇒ Training Securities Commission employees

- **FIESTA II**

This program includes a sub-program for the Polish capital market, namely assistance to the PSC to meet needs which cannot be financed from other sources.

- **Small- and Medium-Sized Enterprise (SME) Sector Support Program**

This program offers technical assistance to 30 Business Support Centers throughout Poland. The program offers expert advice, training of small- and medium-sized enterprise management, assistance for research projects, access to office equipment, and coverage of current expenses over a specified period of time.

- **Program for Private Sector Development**

The main objectives are to promote the development of consultancy and support services for SMEs, strengthen institutions serving this sector, and support public agencies responsible for the formation of public policy concerning SMEs and promotion of the private sector. This program was established as part of the Technical Assistance Program and as a supplementary program to the World Bank loan program for the development of private enterprise.

- **STRUDER**

This local development program offers direct financial support to SMEs and small infrastructure projects. STRUDER also offers training and consultancy services.

- **JOPP Venture Support Scheme**

The primary objective of this program is to support the creation and development of joint ventures. Funds available through the JOPP program are designated for joint ventures in which at least one partner comes from an EU member country and one from Poland, with the condition that 75 percent of capital interest is held by either or both of

these two partners, or any company planning to form, develop or restructure a joint venture in Central and Eastern Europe. Financial assistance is divided into four different facilities corresponding to the different phases of forming a joint-venture:

- ⇒ Identification of possible projects and potential partners,
- ⇒ Feasibility studies on identified investment projects,
- ⇒ Capital requirements,
- ⇒ Training, technical and managerial assistance.

2. BRITISH GOVERNMENT KNOW-HOW FUND (KHF)

Since its creation in 1989 by then-Prime Minister Margaret Thatcher, the Know-How Fund has spent over GBP 50 million in Poland - more than has been spent in any other Central European country. Given the leading position of the London financial markets, much of this effort has been devoted to cooperating with developing the Polish banking sector.

The Know-How Fund has organized and conducted the following:

- \$75 million contribution to the Polish Bank Privatization Fund, the second largest donation to the Fund,
- \$8 million to help Bank Depozytowo-Kredytowy, Bank Zachodni and Powszechny Bank Gospodarczy restructure bad debts,
- \$17 million granted to Bank Depozytowo-Kredytowy, Bank Zachodni and Powszechny Bank Gospodarczy to set up investment funds, to restructure debtor enterprises,
- Support for the work advisers who helped privatize Wielkopolski Bank Kredytowy, the first state-owned commercial bank to be privatized,
- Support of advisers on the Bank Gdanski privatization,
- Consultants to advise on a privatization strategy for the remaining state-owned banks, at the request of the Ministry of Finance,
- Advisors who helped the Ministry of Finance implement the "Enterprise and Bank Restructuring and Privatization Act,"
- Advisors who have worked in many individual banks; an adviser working permanently at the Polish Banks Association,
- Training courses at the International School of Banking and Finance in Katowice and the Gdańsk Banking Academy. Now a KHF-supported link between the Katowice School and a leading UK banking school,
- Banking Resource Unit, established in September 1985 to provide services to all Polish banks.

In addition, the Know-How Fund is working with Bank Gospodarki Żywnościowej to work out its bad debts. The KHF cooperating with the National Bank of Poland on a series of training seminars, KHF advisers and policy issues and with the Ministry of Finance to introduce a new system of regulatory returns. The KHF founded SG Warburg as lead adviser to the Ministry of Privatization in the Mass Privatization Program.

3. THE WORLD BANK

The World Bank was established in 1944 to support and solve the problems of member countries and to promote economic and social progress in developing nations by helping raise productivity. It consists of the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA).

The World Bank established an office in Warsaw in July 1990. It is staffed by international and Polish experts who help with project implementation, provide hands-on technical assistance and advice, and maintain a close dialogue with Polish authorities to keep the Bank program on track. Six priority areas receive World Bank attention:

- Restoring macro-economic stability and strengthening creditworthiness,
- Supporting private sector development
- Improving social support services,
- Rebuilding basic infrastructure,
- Reforming the energy sector,
- Protecting the environment.

From July 1990 through June 1995, Poland has received 21 loans totaling \$3.87 billion, of which \$1.8 billion has been disbursed. Generally 20 percent of the total is used annually.

ITEM	START-1995	1995	1990-1995
Undisbursed commitments	2,302		
Commitments		215	3,872
Gross disbursements		585	1,789
Repayments		0	0
Net disbursements		585	1,789
Interest and charges		107	252
Net transfer		478	1,537

Tab. World Bank commitments, disbursements, and net transfers in Europe (1990-1995) (million USD).¹⁵

Three major projects related to the capital markets and underway in 1995 were:

- **Privatization and Restructuring**
A \$140 million line of credit to finance operations and fees to the National Investment Funds of the Mass Privatization Program. Technical assistance is also provided to the Ministry of Privatization.
- **Enterprises and Financial Sector Adjustment Loan**
Direct support to the Government of \$400 million. The first tranche of \$100 million was used for debt reduction. The second tranche of \$125 million went to the Ministry of Finance to be combined with budgetary funds for an

¹⁵ Source: "The World Bank Annual Report 1995"

"intervention fund" to support disrupted companies. The Industrial Development Agency administers the fund. Conditions and use of proceeds of the next tranche are expected to be concluded for a June 1996 release of funds.

- **Financial Institutions Development**

This \$200 million loan assists Polish banks. The first project has been completed, a "twinning" of seven Polish state commercial banks with seven foreign banks. Work on the second project, integrated automation of state commercial banks, is underway but expected to take significant time to complete.

A new project under discussion is the creation of regional investment (venture capital-type) funds aimed at the small- and medium-sized enterprise sector. The Bank is seeking partners (ministries, banks, etc.) and anticipates a 1997 start date. In addition, the Government of Poland has asked The World Bank to focus on two priorities: social support, including pension reform, and the coal sector in the near term.

4. EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

The EBRD is a multi-national institution established to assist the countries of Central and Eastern Europe to develop into market-oriented economies.

Specifically, the EBRD promotes the development of the private sector within these economies through its investment operations and through the mobilization of foreign and domestic capital. The EBRD assists companies that have difficulty in securing financing. It complements the efforts of other lenders. The EBRD provides project-specific direct financing for private-sector activities, restructuring and privatization, or financing of infrastructure that supports these activities. Joint ventures have been a major benefactor of bank lending, particularly those with foreign sponsors.¹⁶

Project	Banks Funds in million ECU
• Equity investment in BTUiR "Heros", a Polish non-life insurance company	1.5
• Polsko-Amerykański Bank Hipoteczny SA - to assist with financing larger construction projects	12.4
• Warsaw Distribution Park Sp. z o.o. design and construction	6.12
• Mass Privatization Program - Equity Facility	44.64
• Polski Fundusz Leasingowy SA - equity investment in a leasing company	1.4
• Faure & Mchet Logistics - to develop and operate a modern logistics park	8

Tab. List of projects approved by European Bank in Poland in 1995 as of 25.08.1995r.

The European Bank for Reconstruction and Development has supported the Mass Privatization Program (MPP) and participated in the privatization of State-owned companies (e.g., Metalplast, and Bank Przemysłowo-Handlowy in Krakow). In 1994 EBRD provided the National Investment Funds with working capital of ECU 44.36 million and with ECU 52.30 thousand for NIF Environmental Training. In 1995 EBRD approved projects on technical cooperation, such as the NIFs Legal Due Diligence and the MPP Equity Facility Due Diligence.

EBRD has signed loan agreements with 11 of the 15 NIFs which are to manage the assets of companies included in the Mass Privatization Program. The loans, totaling \$33.5 million, provide the basic financing to enable them to begin operations, and to provide the basic management services to companies included in the program.¹⁷

¹⁶ "Financing with the EBRD", April 1994

¹⁷ "New Europe", No 218(969), 21.08.1995

The EBRD offers a wide range of financial instruments and takes a flexible approach to structuring its financial products. As a guideline, the standard minimum lending requirement is ECU 5 million. The EBRD will consider a higher amount if a project has fundamental benefits for the country. While the EBRD generally does not provide direct funding to small- and medium-sized businesses, it does have a number of instruments to reach privately owned SMEs (credit lines, guarantees, equity funds and early stage capital).

Through the following financial institutions, the EBRD provides financing for small- and medium-sized investments:

- Polish Development Bank,
- ING Bank,
- Raiffeisen-Centrobank SA,
- AmerBank,
- Kredyt Bank,
- Housing Credit Line,
- District Heating Credit Line, Wielkopolski Bank Kredytowy ,
- Pioneer Investment Fund,
- Polish Private Equity Fund,
- Caresbac-Polska SA,
- New Europe East Investment Fund,
- European Renaissance Capital,
- Polish Business Advisory Service (PBAS).

Total EBRD financing since 1991 was ECU 885.32 million; of this, equity investments were ECU 257.32 million and loans/guarantees were ECU 627.70 million.

5. INTERNATIONAL FINANCE CORPORATION (IFC)

The International Finance Corporation (IFC), a member of the World Bank Group, invests directly in private sector companies without government guarantees.

IFC has been active in Poland since 1987. It approved its first investment in 1988 and opened a resident mission in 1990. After providing advisory assistance to the Government of Poland in the early days of the transformation, IFC developed strong activities in project finance, advisory services and capital market development.

IFC's committed investments in Poland to date amount to more than \$367 million in equity and loans in 35 projects in various sectors, including manufacturing, services and banking. Small investments, as low as \$100 000, are processed locally through a credit line with the Export Development Bank and targeted at small-and medium-sized enterprises.

IFC invests in most types of productive enterprises. Investments in Poland have covered a wide range of projects, both large and small, such as manufacturing, agribusiness, mining, hotels, transport and storage, and various financial institutions.

IFC's investments in Poland include:

- Pilkington-SandoGlas: \$67 million in equity and loan,
- Huta Warszawa-Lucchini: \$42 million in equity and loan,
- Bristol Hotel: DEM 17 million loan,
- Warsaw Corporate Center: \$11.7 million in equity and loans,
- Polam Piła: \$15 million loan,
- Pamgas: \$10 million equity,
- Amoco Coal Bed Methane: \$8.6 million in equity,
- Intercell: \$7 million equity and \$11 million debt,
- RP Telecom: \$8 million equity, \$30 million debt and \$40 million syndication ,
- International Paper: \$24 million debt and syndication for \$18.8 million ,
- Bona: \$2 million loan,
- PPMS Opole: \$1 million in equity and \$4.5 million debt,
- Nesky Batteries: \$2 million equity,
- Globi Polish Retailing: \$10 million equity investment,
- CETAL: \$33.3 million loan and quasi-equity,
- Export Development Bank: DM 30 million credit line through EDB to finance medium sized enterprises,
- Global Environment Fund: \$5 million grant to finance the promotion of efficient lighting in Poland.

Capital market assistance includes:

- Twinning Arrangement: In collaboration with IBRD, IFC paired nine regional Polish banks with one foreign bank each, in a multi-year program of technical assistance,

- International Bank in Poland: \$3.2 million equity (15 percent) in a joint venture (three foreign and two Polish banks plus IFC) to provide a broad range of banking and other financial services.
- Two Venture Capital Funds: Private Equity Fund of Poland with \$25 million of equity (10 percent IFC) and New Europe East Investment Fund with \$200 million of equity (5 percent IFC).
- Heller-Handlowy Factoring: \$600,000 equity (20 percent) to establish the first factoring company in Poland.

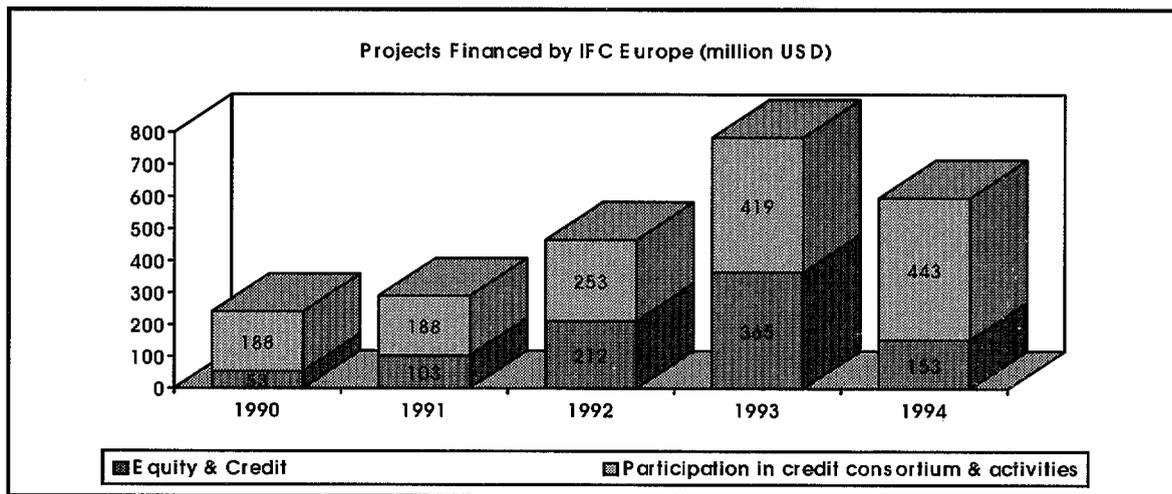
IFC organized, partly financed and manages the Polish Business Advisory Service, a project development facility to help small-scale entrepreneurs develop their business and access bank financing.

IFC has been involved in the privatization in Poland since 1989. In summer 1993, IFC participated in the privatization of four companies: Odra, Gorazdże, Strzelce Opolskie and Opolwap. Previously IFC privatized Swarzędz Furniture Enterprise by the first public offer.

At present IFC is preparing a strategy for the National Investment Funds. The following factors are taken into consideration:

- Equity and loans for the particular Mass Privatization Program companies,
- Equity and loans for groups of companies with a similar production centered in the one National Investment Fund,
- Loans for NIFs to invest in companies from their portfolio.

Chart 23



IFC's future investments are expected to continue at last year's strong pace and to follow the evolving needs of the Polish economy. Among others, the IFC should take a leading part in financing infrastructure projects in Poland. Given budget constraints, needed investment in infrastructure will have to attract private funds. With its long experience in financing infrastructure projects worldwide, IFC is in a unique position to help structure such investments on a private sector basis, without government guarantees. IFC is already considering investment projects in telecommunications, power, roads and environmental services.

6. POLISH-AMERICAN ENTERPRISE FUND (PAEF)

The Polish-American Enterprise Fund is a private, non-profit corporation established under the Support for East European Democracy Act of 1989 (SEED Act) to promote the development of the Polish private sector and of policies and practices conducive to such development.

The Polish-American Enterprise Fund is govern by an independent Board of Directors, authorized to receive \$259 million in capital from the US Government. These monies have been supplemented with an additional \$101 million in equity capital from other sources for parallel investment through the Polish Private Equity Funds.

The PAEF's mission is to encourage private sector development through equity investment, loans and technical assistance for private business in Poland. It started operations in May 1990. Since then, PAEF has recognized the need to extend its reach through specialized financial institutions that can distribute capital quickly and effectively. In response, it established a number of financial intermediaries to provide financing for small business, housing development, home mortgages, and the broad commercial needs of the emerging Polish private sector:

- Enterprise Credit Corporation -- 3,400 loans, \$90 million ,
- Polish-American Mortgage Bank -- approved loans more than \$9 million,
- First Polish-American Bank -- to service mid-sized companies,
- Housing Development Corporation (HDC),
- Fundusz Mikro - for small and new businesses.

PAEF has assisted in the transfer of Poland's State-owned enterprises to private hands. As privatization gradually accelerated, PAEF has identified and supported a number of privatized companies with competent management, unique products and competitive advantages that contribute to success. In the process, PAEF has pioneered a new form of privatization, called "capital-management" privatization. Typically, PAEF works with the management of such companies to purchase company shares from the State Treasury (capital privatization) and then provides the investment capital needed for growth. List of equity investments during 1994 include:

- Borowskie Kopalnie Granitu Co. Ltd. -- \$1.6 million,
- Computerland Poland SA -- \$4.1 million,
ESPEBEPE construction company listed on Warsaw Stock Exchange --
\$2.4 million,
- Huta Szkła Jarosław SA -- \$4.1,
- IPA-BOSS Co. Ltd. Information Publishing Agency -- \$0.7 million,
- Mataczyński Co. Ltd. Printing House -- \$1.8 million,
- Midwest Traders International Co. Ltd. -- \$2.2 million,
- Pakpol SA Poland's leading supplier of laminated plastic packaging --
\$ 5.8 million,
- Stomil Sanok SA -- \$4.5 million,
- Kruk Co. Ltd. the oldest jeweler in Poland -- \$2.9 million.¹⁸

¹⁸ Polish-American Enterprise Fund "1994 Annual Report"

7. UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

The United States Agency for International Development (USAID) opened an office in Warsaw in 1990. The agency has identified three strategic areas of assistance to Poland: private enterprise development, financial sector development and local government capacity building. The United States Government has allocated \$800 million in assistance to Poland. Of the total assistance, \$259 million has gone to the Polish-American Enterprise Fund (See Part IV, Sec. 6) and \$200 million to the Bank Privatization Fund.

USAID-funded projects help to develop a competitive financial sector which meets the needs of a market-oriented economy. Among USAID's financial sector projects and their accomplishments are:

- **Over-the-Counter Market**

A joint-stock company recently was established to own and operate an Over-the-Counter Market in Poland. Impetus for this came from 43 Polish brokerage houses, supported by USAID-funded technical assistance. (See Part I, Sec. 3).

- **Polish Credit Rating Agency**

A new Polish Central European Rating Agency is being developed. By rating debt instruments, the new agency will provide safety to investors who want to buy Polish debt instruments and market discipline to those entities who want to issue them.

- **Financial Services Resource Center (FSRC)**

Now operational, this Center was designed to transfer advanced corporate finance and investment banking skills to Polish banks, to establish a foundation for the infrastructure required to develop a local market for these services, and to provide private Polish companies with professional capital markets, operational and financial restructuring assistance that they would otherwise be denied.

- **Bank supervision**

Strong supervisory capability increases confidence in the banking sector. USAID is the only donor supporting banking supervision activities. Since mid-1992, it has funded a project to advise the National Bank of Poland (NBP) and its General Inspectorate for Banking Supervision. In recent years the focus of the project has been to develop on-site inspection procedures, policies and procedures for dealing with problem banks, strengthening off-site supervision, and developing risk-based supervisory approach. A major milestone was the first-ever inspection of a major bank.

- **Strong improvement in cooperative banks**

Some 300 independent, local cooperative banks continue to show strong operating improvements based on a comparative peer-bank statistical analysis. Agricultural Cooperative Development International, which developed the analytic tool, has provided training and technical assistance to Poland's cooperative banks. It has helped establish two regional, independent banks as well as a trade association to support the needs of both local and regional cooperative banks.

- **Market-based construction and mortgage lending system**

USAID's pilot mortgage program exceeded its target of 500 mortgages, and mortgage production at the BUD Bank was up significantly. These project mortgages represent an investment of more than \$75 million in the housing sector and some 3,750 jobs. The BUD Bank designed two new mortgage instruments and changed the interest rate index to make the mortgage fund more competitive and market sensitive. Participation in the fund has expanded from two to seven banks.

- **Polish Credit Union System**

With USAID assistance, the Foundation for Polish Credit Unions and the National Association of Cooperative Savings and Credit Unions have established a national credit union movement in Poland. More than 100 credit unions have been activated and have more than 75,000 members. A Stabilization Fund has been established as well as companies to provide life savings and loan protection insurance and fidelity bonding.

- **Grain marketing and warehouse pilot**

A recently undertaken pilot project will help establish a system of licensed public warehouses. These are critical to the development of a Commodity Exchange. A pilot using 20 existing grain warehouses around the country is underway. (See Part I, Sec. 14)

- **Collateral law, bankruptcy law and other legal reforms**

The purpose of USAID's IRIS-Central Europe project is to create a positive commercial law institutional framework for the development of the financial sector in Poland and five other countries. The project assisted in the development of a modern Collateral Law which is now under consideration in Parliament.

Part V.

**RECOMMENDATIONS
CONCERNING DEVELOPMENT OF
POLISH CAPITAL MARKETS**

1. ISSUING RECOMPENSATION PRIVATIZATION COUPONS¹⁹ (RECOMPENSATION CERTIFICATE)

1.1. Genesis of Project

The State Treasury currently has liabilities relative to retired and disabled pensioners and government sector employees for benefits that were not paid to these groups during the years 1991 and 1992. At the present time, the total of these liabilities is estimated at more than PLN 6.5 billion (approximately \$2.6 billion). This amount is owed because the Sejm accepted four decisions related to unpaid benefits handed down by the Constitutional Tribunal. It also includes interest on the benefit amounts due.

At present it seems as if the only way the State Treasury can satisfy these claims is to issue compensatory certificates (bonds with a defined nominal value) which would be convertible into State Treasury property allocated for privatization. It should be noted here that the program of certificates would encompass approximately 12 million persons.

Government sector employees would receive bonds whose value is arrived at by multiplying the number of employment months for the period to which the decisions of the Constitutional Tribunal pertain by an established, flat rate of compensation per month (appropriately reduced for non-full-time employment). The flat rate would be adjusted for the rate of inflation on consumer goods and services for the entire period of delay to the end of 1995.

Technical Aspects of Certificate Distribution

The distribution of the bonds would consist of their being "dematerialized" and deposited into cumulative accounts held in the provinces by brokerage houses to be chosen by tender. Each beneficiary of the program would receive a depository receipt representing the value of bonds deposited in his/her name.

Depository receipts would remain valid for a period of 10 years. Their nominal value would be adjusted at the end of March each year by the rate of inflation for the previous year. The bonds would have the status of a "privatization coupon." and would be transferable in the secondary market. They could be used as payment for shares purchased from the State Treasury and for other State assets, including land, buildings and farming equipment sold by the State Treasury Agricultural Property Agency. The certificate-holder also could use it to receive an exemption from liabilities relative to the State budget, with the exception of tax liabilities.

Bondholders could elect to sell them immediately, transfer them to a segregated account with a brokerage firm or to deposit them (invest) in an investment fund.

¹⁹ There are some difficulties in the proper and adequate translation of the „bony rekompensacyjne”. Taking under consideration the nature of this security we have decided to use the expression „recompensation bonds” instead of „recompensation certificates”.

It is essential for the program's success to provide an appropriate supply of assets for exchange. During its first year, the program would require sufficient shares to cover 40 percent of the total value of certificates issued, with another 30 percent of certificate value in shares required during each of the two following years. In addition, the shares of privatized companies need to be admitted to public trading and the companies themselves need to be attractive to potential investors. For this reason, the Government wants to combine implementation of the compensatory certificate program with the privatization of the banking sector.

Another option being considered would involve linking this program with the program of National Investment Funds or with the activities of mutual funds. This variant provides for two possibilities:

- Using the NIF program as a base for creation of a second investment portfolio and organizing it in the form of an open-end fund vested with the task of making investments in the certificates, or
- Depositing certificates with National Investment Funds to cover increases in their capital.

1.2. Significance of Project to Capital Markets

- Satisfying the State Treasury liability on the basis of a bond issue would accelerate the process of privatization. Because the value of certificates will total approximately PLN 6.5 billion, the market value of State assets offered for privatization will also have to approach this amount. By comparison, the book value of the companies participating in the National Investment Fund program is approximately PLN 7 billion.
- The project will require involvement of both the National Deposit of Securities and brokerage houses. Bonds will be issued in dematerialized form, with the names of entitled people recorded in a Central Register. These owners then can transfer their certificates to investment accounts held by brokerage houses.
- The bonds will constitute a new kind of security that will be used to purchase the shares of privatized companies, simultaneously creating the demand for assets that are in the process of being privatized.
- To avoid disrupting cash purchases of these same companies' shares, a limit on the quantity of shares allocated for privatization available for purchase using the bonds can be set restricting purchase to approximately 20 percent of the capital of a given company.
- Given these conditions, the Government will need to privatize and allow for public trading shares of some large, prosperous firms, companies which the Government has been unwilling to make available to investors thus far. This is particularly true of banks, telecommunications sector companies, oil refineries, power plants and copper extraction and processing firms.

- Foreign investors will be allowed to participate in secondary market trading of the bonds and the shares of the companies mentioned. This will mean increased availability of attractive investment possibilities and will simultaneously increase the level of interest in the Polish capital market.
- The capitalization and liquidity of the Polish capital market will increase as a result of this program. This will give rise to an impetus possibilities for the development of retirement funds in Poland, which will constitute a foundation for reform of the social insurance system.

1.3. Recommendations

1. Develop legal regulations needed to introduce a system of compensatory privatization bonds.
2. Analyze the sensitivity of the Polish capital market to the implementation of this program. This study would be useful for an early definition of any possible negative consequences of the program's introduction as well as to devise responses to them.
3. Analyze the option of creating investment funds that would issue units of participation on the basis of compensatory bonds deposited with them. This includes legal steps needed to facilitate the process.
4. Develop concepts for preparing a register of all persons entitled to certificates and for creating the Central Register of Beneficiaries (approximately 12 million persons).
5. Compile a list of persons entitled to certificates and establish the level of the State Treasury's liability relative to each of them.
6. Define a computer system that would enable the creation of the Central Register of Beneficiaries.
7. Develop appropriate concepts for omnibus accounts.
8. Develop and implement a concept for the distribution of deposit certificates.
9. Purchase computer equipment required to service the Central Register of Beneficiaries.
10. Monitor program implementation and the level to which compensatory bonds are being utilized.
11. Develop program to disseminate information about how to receive bonds and the options for bondholders.
12. Train those persons who will implement the program.

2. IMPLEMENTING REFORM OF SOCIAL SECURITY SYSTEM AND DEVELOPING LEGAL BASES FOR CREATING RETIREMENT FUNDS

2.1. Genesis of Project

The realities of market transformations in Poland have made it necessary to reform the social insurance system in this country. The current system of retirement pensions run by Zakład Ubezpieczeń Społecznych (ZUS - State Social Insurance Company) is under strong pressure. Insurance premiums are collected from all employees (with the exception of farmers) amount to 45 percent of total remuneration. State Treasury payments to supplement ZUS come to approximately 21 percent of total budgetary expenditures. This excessive social insurance burden clearly is becoming a problem for the budget and the population. In addition, during recent years the number of retired people has increased significantly. In 1970 one person receiving benefits was supported by five people working and paying premiums. That ratio has declined steadily: just over three in 1980, down to two in 1992, down to 1.7 in 1995. This has resulted in a significant increase of the insurance premiums.

If the current system remains as is, several years from now either a shortage of money for retirees and disability pensioners will occur or, given already exorbitantly high premium levels, money will have to be printed, resulting in a rise in inflation.

In December 1995 the Government approved a set of directives for reform of the social security system. Approximately 20 legal acts will have to be prepared or amended within the process of reform. The deadline for its implementation has been set for the year 2002. The basic concepts are discussed in Part II, section 9, of this report. Regardless of the final structure, the basic requirements of any program of reform that is introduced will include:

- Introducing tax relief for investment (saving for retirement) within the retirement plan system (this reduces budgetary revenue and, therefore, reduces the ability to subsidize current retirement pensions),
- Dividing premium payments between employees and their employers,
- Creating a system to register the insurance status of all citizens,
- Creating the necessary legal infrastructure including regulations pertaining to the management of retirement funds,
- Creating a body to monitor the activity of the pension funds,
- Creating an organizational base, including education of specialists in retirement fund management,
- Developing the capital markets further.

2.2. Significance of Project to Capital Markets

In developed economies, most of the resources that are accumulated by retirement funds are reinvested in capital markets. It is estimated that in countries where they exist, funds of this kind account for approximately 50 percent of stock exchange capitalization. A brief list of the primary ways in which the capital markets will be affected follows:

- Individuals can set aside savings for their retirement with capitalized retirement funds. This will in turn enable the creation and stimulate the development of these kinds of institutions.
- Future retirement benefits will be contingent upon the forward-thinking capabilities of the final beneficiaries. That will make forward market transformations in Poland and propagate entrepreneurial thinking.
- Creation of demand for the shares of good companies which represent real possibilities for long-term investment for the retirement funds.
- Investments made by capitalized retirement funds will have a positive effect on new private companies seeking capital as well as on the privatization of large, attractive state enterprises.
- A new type of institutional investor will be created adding to market liquidity.
- The existence of retirement funds will help stabilize the capital markets because of the long-term investment strategies they are likely to adopt.
- Polish investment managers will gain knowledge about the techniques involved in preparing and analyzing long-term investments.
- The sector of the smallest, best, most dynamically developing companies will acquire a new possibility for acquiring capital - the issuance of shares and bonds.
- Because retirement funds may hedge their positions through investments in the derivatives market, reform also will serve to support the development of the financial market.

2.3. Recommendations

The issues related to reform of the retirement system in Poland cover a wide range of topics. They involve remodeling an entire spectrum of macro-economic relations in Poland over the next several years. This requires both advance preparation as well as detailed analysis of possible solutions. It also requires the State to provide vast resources. Additional support is needed from foreign institutions. The following are basic areas in which foreign assistance can be useful:

1. Preparation of simulations and calculations to forecast retirement and disability pensions over the next few years.

2. Technical assistance to introduce a general registration system of those insured and record their insurance status.
3. Analyses showing the direction of development of the Polish economy and the situation of ZUS given a set of assumed conditions for the system of taxation.
4. Analyses of the implementation of parallel concepts for the functioning of various retirement fund systems.
5. Assistance from Western experts to prepare a legal framework for the reforms to be implemented.
6. Support for training civil servants whose jobs are affected by the reform of the system.
7. Preparation and support for a public education program, aimed at explaining to the Polish population the need for reform.

3. CREATING CAPITAL MARKET COMPUTER SERVICING AND INFORMATION SYSTEM

3.1. Genesis of Project

Currently no integrated computer system provides investors and institutions with access to complete market information. The result is redundancy and duplication, resulting in increased costs to collect and store information.

Each of the institutions involved -- the Polish Securities Commission, the Warsaw Stock Exchange, the National Deposit of Securities and the Central Table of Offers -- has its own internal computer system to which no direct external access is possible. Each institution collects, processes and uses the information it needs at its own cost. Others cannot use this information, even if they are also key players in the capital markets.

At the initiative of the Polish Securities Commission, a recently implemented program uses the electronic information transfer system (EMITENT) to transfer information between entities active on the securities market. The limited cooperation that is being generated on the basis of this system lacks any characteristics that would reflect an integrated approach to information exchange. This system allows its users solely to transfer data; it has no capacity to allow a user to access records kept by another participant in the system. In its present form, the system does not allow searching for needed data within the information resources collected and stored by other institutions that are participants of the system.

Because each institution has its own information system, this causes immense difficulty in supervising the correct functioning of the market. To change this situation, the Polish Securities Commission is trying to create a specialized database based on an ORACLE system platform that automatically would store any data that was transferred to it through the EMITENT system. In the future, this can become a foundation on which to create a database encompassing all of the institutions of the capital markets and bring these institutions together within an integrated system, allowing exchange of necessary information.

An integrated information exchange system has several benefits. It would result in coordinating the collection, storage and processing of data. The resulting database allow each institution to store necessary data and eliminate the need for each to gather data individually. By introducing consistency in the methods of storing and accessing information, the institutions can share their information resources. In addition, certain records can be made available to external users (companies dealing in the collection and processing of data, investors) through, for instance, the Internet. A system of this kind would be a solid foundation for further development of the capital markets as a whole. The improved database currently under development by the Polish Securities Commission is a good base on which to start.

3.2. Significance of Project to Capital Markets

- The project would make market information available to investors and companies engaged in accumulating and processing data. This ensures open and equal access to information. Through the appropriate standardized and published interfaces, market participants could gain access to specific sets of universally available information and put them to use.
- Maintaining a database with information about the capital markets and providing full access to this database would facilitate and rationalize the process of supervising the market's functioning and raise the security in trading, thus contributing to a greater clarity of the entire market.
- Creating an integrated database used by specific institutions active in the capital markets would help to decrease the total costs of gathering and storing data.

3.3. Recommendations

1. Financial support is needed to employ specialists experienced in developing a strategic concept of computer support for capital markets. Therefore, it is necessary to identify the financial resources required to create the system, to develop a list of priorities and to secure full coordination for them. The information exchange system should be operated on a commercial basis.
2. Standard interface for information exchange must be prepared.
3. Financial resources must be identified to support implementation of the information exchange system. The scale of these resources will be defined in a strategic analysis of the project as a whole. These resources must cover the projected cost of purchasing required computer equipment, of creating an appropriate access network between system participants and of acquiring an appropriate software application.
4. Assistance is required to train specialists who will help to create and develop the system
5. Assistance will be needed to develop software that standardizes gathering, storing and disseminating information, therefore creating a dispersed database. The actual creation of this database also will involve creating a network for transferring and accessing data by market participants.
6. Additional resources will be needed to expand to all institutions of the Polish capital market the system being created by the Polish Securities Commission,
7. Assistance is required to develop appropriate security measures for the system, measures which will make unauthorized access impossible and will limit external users to accessing only specifically defined system resources.

4. IMPLEMENTING CONTINUOUS TRADING SYSTEM ON WARSAW STOCK EXCHANGE

4.1. Genesis of Project

Quotations on the Warsaw Stock Exchange are made on a daily quotation system based on the investors' sale and purchase orders. These orders are supplied to the Warsaw Stock Exchange (WSE) by brokerage firms on computer diskettes. At the Exchange, data from the diskettes is loaded into a central computer. Then a specialist in a given company stock establishes a price per share for the stock for that day. The price established must ensure a maximum amount of trading in the shares of the company. In cases where there are surplus purchase or sell orders, supplementary trading is organized to balance the order book, enabling investors to purchase and sell shares at the fixed, previously established price.

This project is intended to develop a system of continuous quotations. Orders coming into the WSE from brokerage houses would be entered into a database and wait for a matching counter-order. Transactions would be concluded automatically at the moment a matching counter-offer appeared in the system.

Special facilities should be created to allow monitoring of orders coming into the WSE, as investors would place orders throughout the trading day, responding to their observations of the price fluctuations.

Brokerage houses would be connected to a computer network giving them a direct access to the WSE. In addition, they would use this network to transfer transactions to the Exchange, submitting them as soon as an investor had placed an order.

Continuous trading on the WSE will mean that brokerage houses must implement new computer applications. For a number of them this transformation may be difficult.

4.2. Significance of Project to Capital Markets

Implementing this project will result in:

- Further development of the WSE's performance,
- Increased liquidity in the trading of shares of the best companies on the Warsaw Stock Exchange,
- Increased investor activity (measured by the number of orders),
- Making all activities more efficient, increasing the speed with which transactions are concluded,
- Greater clarity for the market,
- Limiting the possibility of artificially dictating prices through appropriate orders for the sale or purchase of shares.

4.3. Recommendations

1. Enlisting assistance is advisable for this project. It will be necessary at first to do an analysis that would define the detailed technical conditions, equipment needs and legal and formal base required for the creation of an efficient system of continuous trading on the Warsaw Stock Exchange. The analysis also should define precisely those requirements that need to be met for the system to be secure and for it to function efficiently. This pertains both to how transactions are concluded and how unauthorized access to the order transfer system is prevented.
2. On the basis of expert analysis, the resources needed to complete the project as a whole must be defined. Based on this analysis, we will need to find the appropriate financial resources to create a computer network connecting the Warsaw Stock Exchange with brokerage house and to purchase the appropriate computer equipment and software that will match offers submitted, conclude transactions and transfer the information to the National Securities Depository.
3. A system of continuous quotations on the WSE will necessitate modification of computer systems currently being used by brokerage houses. An appropriate analysis must be done to determine if there are any possibilities for assisting brokerage firms in achieving this modernization.
4. A formal, legal framework must be created to guarantee the safety of transactions in the market and to protect against third-party influence on prices.
5. Assistance is needed to implement a "short sale" system on the Polish capital markets.
6. New regulation regarding guarantee funds must be prepared.
7. New regulation on the settlement of transactions in the National Deposit of Securities also is needed.

5. DEVELOPING CAPITAL MARKET FINANCIAL INSTRUMENTS FOR MUNICIPAL FINANCING

5.1. Genesis of Project

The Act on Bonds provided the basis for issuing communal/municipal bonds. Currently, within the existing formal, legal frameworks, communes (gminas) attempt to issue bonds that will remain isolated from public trading. The monies acquired in this manner will be used primarily to finance long-term local government capital requirements that cannot be satisfied from the available budgetary resources. It would also secure the funds needed for the development of local democracy. At the present time, bonds issued by communes cannot be traded publicly.

The objective of this project is to create clear, formal, legal requirements for the public issuance of bonds by communes and municipalities on the basis of prospectuses. The project also would allow for the introduction of communal/municipal bonds to be traded on a secondary market outside of a stock exchange on the basis of information memoranda.

The project also would guarantee appropriate standards of investment risk by creating a system for collecting information about the financial status of communes issuing bonds. This same purpose would be served if specialized agencies would manage a system of rating those communes seeking permission for the public sale of their bonds. Those agencies would assume responsibility for the information they disseminated. This will lead to the creation of a clear system for monitoring the financial status of communes. The system should be there to provide an objective evaluation of the value of bonds issued by specific communes.

5.2. Significance of Project to Capital Markets

- The most essential effect of the actions to be undertaken would consist of the expansion of the palette of instruments available in the Polish capital markets.
- Possibilities for financing the local authorities would increase. Specific communes or associations of communes would be able to initiate projects that exceed their current budgetary capabilities by financing them through bond issues.
- Possibilities for financing so-called local initiatives by small communes and their associations would increase. This, in turn, would involve residents in the implementation of investment projects important to the community.

5.3. Recommendations

1. Outside assistance will be needed to finance the work of experts in developing a formal, legal basis for the public issue of communal/municipal bonds. On the basis of experiences gained in other counties, it will be necessary to develop financial requirements for communes and methods for presenting the financial situations of communes that will guarantee appropriate levels of investment security for potential investors.
2. Cooperation will be needed to lay a foundation for creating specialized agencies to rate communes. Cooperation also will be essential in developing a system of rating communes.
3. Cooperation will be need in developing the financial reports that will be provided to the State Securities Commission by communes seeking approval for a public bond issue and by communes whose bonds were admitted to public trading.

6. PREPARING FORMAL, LEGAL BASIS FOR CREATION AND FUNCTIONING OF COMMODITIES EXCHANGES

6.1. Genesis of Project

Currently no legal regulations govern the creation or functioning of commodities exchanges in Poland. Work has been under way in the Ministry of Industry for some time on the draft of an act that would regulate these issues. It seems, however, that these efforts should be intensified at this point in time. Their further pursuit should take into account the entirety of the commodities market and the market of derivative instruments. It would seem desirable to enlist the assistance of the State Securities Commission for preparing the regulations that are needed in this sphere.

The actions undertaken should lead to the creation of a legal and formal framework that would clearly define the principles for creating and operating commodities exchanges in Poland. Legal regulations should guarantee clear procedures for the operation of commodities exchanges, define the manner for concluding transactions and the methods for supervising this segment of the market.

Supervision over commodities exchanges should rest in the hands of the State Securities Commission or another independent institution called into being for this explicit purpose. A situation which allows the Ministry to have influence over what happens on the market should be avoided. The supervision under discussion should above all pertain to the functioning of the futures market, but should also encompass the current (physical) transaction market to a certain extent.

The standards related to making information available to the public in the scope required by law require certain guarantees. All investors must be guaranteed full, equal and rapid access to this information.

6.2. Significance of Project to Capital Markets

- The project will expand the palette of financial instruments available for use by investors (futures).
- The project will provide instruments designed to work as security against risk (futures).
- The project will contribute to a concentration of supply and demand for the goods that are traded on agricultural commodity exchanges. This will have a positive effect on the manner in which the prices for these goods are determined and will allow producers of these goods to secure themselves against temporary price fluctuations.

6.3. Recommendation

Continuation of the support of the Chicago Board of Trade to the Warsaw Board of Trade and of USAID to the development of a public warehousing system in Poland.

7. IMPLEMENTING THE OVER-THE-COUNTER MARKET TRADING SYSTEM

7.1. Genesis of Project

Creation of the Over-the-Counter Market is important to the success of Poland's Mass Privatization Program (MPP) and to increase the ability of Polish capital markets to facilitate both economic growth and broad-based private ownership for newly privatized enterprises. Small- and medium-sized companies will be able to raise capital by meeting the lower standards for an OTC listing.

The Polish brokerage houses decided to create the Over-the-Counter Market due to:

- Limited possibilities to change the ownership of the Warsaw Stock Exchange and to increase their influence on the further development of the WSE,
- Broader opportunities to earn revenues from bigger turnover,
- Opportunities of the influence on the OTC trading system as well as the fees arrangements.

Poland's Mass Privatization Program (MPP) is another major factor influencing the creation of the OTC market. Under this program, 28 million share certificates have been offered and will be convertible into shares of the 15 National Investment Funds. The funds will hold stakes in 512 companies (mainly small- and medium-sized regional enterprises) privatized under the MPP.

The Ministry of Privatization has agreed that shares in the privatized companies themselves should be offered publicly at the earliest opportunities, thereby substantially increasing the number of publicly traded shares. The Ministry of Privatization supports the creation of an OTC market to achieve this aim.

The Brokerage Houses Association endorsed the creation of both the OTC Market and an associated self-regulatory organization (an entity responsible for the inception of the Central Table of Offers) to work in conjunction with the Polish Securities Commission (PSC).

The Brokerage Houses Association has appointed a Task Force whose objectives are to:

- Prepare the organizational and management structure of the OTC's ownership,
- Establish the Central Table of Offers as a joint stock company,
- Create the trading system.

With USAID technical assistance, the following targets already have been identified:

- Creation of a self-regulated-organization that will establish an arbitration system and rules, membership rules and ethical standards of conduct, and related regulatory standards. These rules and standards will be drafted to provide fairness of process, investor and issuer protection. They will enhance the participants' ability to serve investor and issuers and broker-dealer compliance with the Polish securities law and related rules and regulations.

- Creation of an entity that will own and operate an OTC trading system ("OTC Operation Entity"). Operational and trading rules will be adopted to increase trading system efficiency, decrease counterparty risk, provide investor protection and insure compliance with the Polish securities law and related rules and regulations.
- Completion of development, and ultimate testing, of an efficient OTC trading system ("OTC Trading System").
- Establishment of telecommunications linkages, clearance and settlement functions, and assistance on a settlement guarantee fund and an investor protection fund related to the OTC Trading System.
- Development of clearance and settlement arrangements to support the OTC trading regulation.
- Assistance to the Polish Securities Commission and the National Depository of Securities on matters related to the development and regulation of the OTC Market, including specific assistance on addressing securities law limitations on primary issuance via the OTC market.

It is expected that the project will bring the following results:

- Fully operational OTC system, and
- Creation of fully operational, self-financed and self-regulated broker-dealer organization, with implemented regulatory, membership, disciplinary, market surveillance and arbitration rules and organizational units capable of fulfilling the self-regulated-organization's legal and regulatory obligations.

7.2. Significance of Project to Capital Markets

The OTC Market project should be continued because it is an opportunity to:

- Develop Polish capital markets further,
- Facilitate small- and medium-sized enterprises in "going public",
- Ensure success of the Mass Privatization Program,
- Increase the efficiency of the market,
- Increase the efficiency of the Warsaw Stock Exchange by creating a competitor,
- Create self-regulated brokerage houses bodies,
- Integrate more closely the brokerage community.

7.3. Recommendations

Foreign assistance should be continued in the future development of the OTC project. All aspects of the project are complicated and need specialized knowledge and assistance, only available with foreign support. The brokerage houses' determination to create the OTC Market should be the advantage.

We recommend development of the following outstanding issues:

1. System for the Polish Securities Commission to monitor activity on the OTC market. For that purpose, there should be prepared:
 - Concept of the system
 - Monitoring procedures
 - Software application
2. Changes in the securities regulation to allow the creation of:
 - Efficient market making activity
 - Short sales
 - Securities lending
3. Training for the market makers on their new tasks.

8. CREATING RATING AGENCY

8.1. Genesis of Project

The Polish Bank Association, in conjunction with some of its members, has identified the need for creation of a rating agency. This agency would be similar to those in Western markets and beneficial to the financial system in Poland. The United States Agency for International Development has provided an advisor to facilitate development of the agency.

Key features of the program include:

- Market assessment,
- Creation of a business plan,
- Preparation of an offering memorandum to raise capital on a private placement basis,
- Educational seminars for a variety of audiences;
- Formal media program,
- Staffing and training in accordance with the business plan,
- Product development to meet the needs of the market,
- Determination and publication of ratings.

This process of institution building and capacity development will result in more extensive acceptance and use of fixed-income instruments and enhance analytical techniques. While the genesis of the project is in the Polish Bank Association, it is anticipated that the rating company will be capitalized independently and have a diverse group of shareholders and its own board of directors.

The market assessment entailed an extensive series of interviews with important market participants. At this time, there is basically no private-sector fixed-income market. There are several reasons for this:

- Inflation erodes confidence in future prospects and results in extremely high, uneconomic borrowing rates.
- A new bond law to permit sale of debt was just passed in June 1995.
- Institutional investor capacity must be defined and developed.
- Company management must enhance financial management skills.
- Fundamental analysis is a relatively new discipline in this transforming economy.
- Equity is easier to sell since routines are well-established now.

The business plan will incorporate traditional elements necessary to form the basis for company establishment. These will include definition of form, a product array designed to meet the identified need in the market; detailed staffing and training plans; educational program on efficient capital markets, ratings and analysis; a marketing plan; a full media program; and protocols for governmental and regulatory relationships. The exhibits will forecast the budget and likely results for the firm.

The outcome of the project will be a professional credit rating agency qualified to serve a regional market. Corollary benefits are expected to include more attention to fundamental analysis in the market, a framework for rational pricing, improved counterpart risk assessment among key financial institutions, a stronger appreciation of the long-term advantages of systematic disclosure on the part of issuers and investors alike, and more effective mobilization of domestic capital as confidence in the system rises.

8.2. Significance of Project to Capital Markets

- The project will have positive impact on the further development of the capital markets.
- A professional, established rating agency should allow dissemination of rating information on a particular instrument to investors. Implementation of Western standards of rating should encourage potential foreign investors.
- The project should define options related to the rating agency's relationship with rating agencies around the world.

8.3. Recommendation

Foreign assistance should be continued to complete the project under development.

9. MODIFYING SETTLEMENT REGULATION TO ALLOW FOREIGN INVESTORS TO INVEST IN POLISH CAPITAL MARKETS

9.1. Genesis of Project

Under existing regulation, investors have difficulty using custodial banks in Poland. In most countries, settlements systems are very similar, and local brokers can trade securities in the local market on behalf of foreign clients, issuing instructions to their clearing banks. In this manner cash and securities are transferred between local brokers, the clearing banks of foreign brokers and the custodial banks of clients, trustees. This process is known as delivery versus payment (DVP).

The process in Poland is complicated by the following requirements:

- International brokers are unable to trade for anonymous clients. For every client who wants to trade in Poland, the broker must open a brokerage 'mirror' account related to the underlying custody account of the ultimate investor. Additionally, such an account may be opened only after the investor or his/her acting trustee produces a notarized Power of Attorney (POA).
- Sale transactions can be entered to Warsaw Stock Exchange only after local custodial banks have "blocked" securities.
- Polish banks are reluctant to allow settlement to take place on a DVP basis and strongly encourage the international broker to settle in U.S. dollars.
- Some Polish banks are beginning to allow DVP settlement, but until the banks unify their procedures, foreign investors cannot trade with any certainty as each of their funds may settle through different Polish banks, subject to differing settlement currencies and therefore different restrictions on dealing from the trustees.
- As the Polish zloty trades in a restricted form only on the currency markets, the international investor is obligated to purchase currency from the bank through whom the trade was routed.

9.2. Significance of Project to Capital Markets

Until the above issues have been resolved, the Polish capital market will not fully benefit from the business available from the global investment community.

9.3. Recommendation

New regulations concerning the settlement of transaction made by the foreign investors must be prepared and implemented.

Annex

List of people that were interviewed or submitted us with the necessary information

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