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UNITED STATES
FINANCIAL SERVICES VOLUNTEER CORPS

MISSION TO POLAND

May 5-12, 1990

OBSERVATIONS, FINDINGS AND RECOMMENDATIONS

May 18, 1990

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UNITED STATES
FINANCIAL SERVICES VOLUNTEER CORPS

Mission to Poland

May 5, 1990 through May 12, 1990

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**UNITED STATES
FINANCIAL SERVICES VOLUNTEER CORPS**

May 18, 1990

His Excellency
Leszek Balcerowicz
Deputy Premier and Minister of Finance
of the Republic of Poland
Warsaw

Dear Mr. Deputy Premier:

On May 11, members of the United States Financial Services Volunteer Corps orally presented to you and other representatives of the Polish Government and representatives of the National Bank our preliminary report regarding the banking system, the development of capital market systems and the privatization of state enterprises in Poland. I am pleased to deliver our final written report to you and your colleagues.

During our eight-day mission, our Bank Team and our Capital Markets and Privatization Team met with officials of the Government and its ministries, the National Bank, Parliament and several banks, as well as with business and labor leaders. The report is based on what we learned from these meetings combined with the expertise of our volunteer private sector group which included commercial bankers, investment bankers, accountants and

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lawyers who actively participate in the international financial and business communities.

Your country has embarked on a bold and historic course. In doing so, Poland has sought the expert advice of the public, private and multi-lateral sectors of the international financial and business communities. We believe that improved coordination and cooperation of these advisors would help Poland accomplish its economic goals more effectively and efficiently.

We are convinced that Poland has the desire and capability to succeed in establishing a free market system. Of course, the road will be long and difficult and will require the patience of the Polish people. There are no easy solutions, but tempered optimism is, we believe, justified.

As you know, we have made specific recommendations and are prepared to cooperate and assist in developing programs, plans and solutions with respect to the matters addressed in the report. These efforts will require that we work in partnership with senior representatives of your Government, the National Bank and the Polish financial and business communities. As I said at our last meeting, if you conclude you have a serious interest in pursuing these recommendations and are prepared to make, in partnership with us, the commitment of people and resources necessary to implement them, you can rest assured that we are ready, willing and able to carry forward in their prompt implementation.

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His Excellency
Leszek Balcerowicz

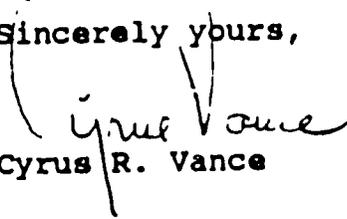
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May 18, 1990

We look forward to discussing the report with you, and other representatives of the Government and representatives of the National Bank. We are confident of our ability to work together. Mr. Birkelund will be writing you in the very near future, reaffirming his comments made at our last meeting.

Once again, my warm thanks to you and all your colleagues for the frank, cordial and productive meetings we had in Poland. We wish you great success in your daunting undertaking.

Sincerely yours,


Cyrus R. Vance

Enclosure

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BANKING

INTRODUCTION

The Bank Team had meetings with representatives of the Ministry of Finance, the Ministry for Foreign Economic Relations, the National Bank of Poland, a panel of Senators and Deputies of Parliament and seven state-owned Polish banks. Each meeting was open, frank and cordial, and we appreciate the unfailing courtesy, patience and hospitality of our hosts.

The Team sought ways to help Poland develop a healthy, competitive and growing free market banking system that is responsive to individual, business and governmental needs. In spite of the brevity of our visit, we think we learned enough to enable us to present the following observations, findings and recommendations.

I. RESTRUCTURING

A. If Poland is to have a competitive banking system which is comparable to the banking systems of its Western counterparts, virtually all of its banks must be restructured, primarily in areas such as financial condition, business objectives and plans, managerial and staff capabilities and internal operations and systems.

Restructuring will be painful because it will, among other things, require dealing with non-performing assets, obtaining substantial new capital, widespread training and, possibly, the reduction of personnel.

B. Any Polish bank which cannot be restructured should be phased out at the earliest possible time or, if its functions are deemed essential to a public purpose, its assets should be transferred to a government entity which would operate at the government's risk.

C. Technical assistance for restructuring which is now being provided or has been promised by governments and multilateral organizations should be augmented by technical assistance from the private sector, including the international commercial banking community.

II. BANKING OPERATIONS AND PAYMENT SERVICES

A. Transactional linkages between the National Bank of Poland and Poland's banks utilizing advanced technology and know-how must be established to allow money to move freely and rapidly throughout the economy.

B. To accomplish this objective, building the technological and operational infrastructure which is essential to support the banking system should be given the highest priority. As part of this process, there must be a clear articulation of the goals and mission of Poland's banking system, the role of the National Bank of Poland in

payment services and the relationship between the National Bank of Poland and Poland's banks.

C. Critical goals are the establishment of a settlement system and the development of an active interbank market, which are vital to the efficient allocation of liquidity within a free market banking system.

III. SAFETY NETS

A. We urge that the Polish Government define the commitments Poland is prepared to make with respect to (1) central bank credit, (2) deposit insurance and (3) support for failing banks. As long as banks are state owned, there may be express or implied commitments in each case. When there is private ownership, the extent of these commitments must be explicitly defined and understood in the market place.

B. Some of these issues are being addressed in a paper which is being delivered directly to the National Bank of Poland.

IV. ACCOUNTING

A. Poland needs to adopt a single comprehensive system of financial accounting and disclosure. After adoption, professionals must be trained in the system. The new system is essential for both banks and enterprises if privatization and a free market economy are to be achieved. Banks need

credible financial statements of borrowers to lend wisely, and investors need credible financial statements of enterprises to make intelligent investment decisions.

B. We understand that no comprehensive system of financial accounting and disclosure exists in Poland. To correct this situation, we recommend that Poland adopt international accounting standards ("IAS"). We do not think that the draft regulation of the Ministry of Finance entitled "Uniform Rules Relating to Double Entry Bookkeeping" which was furnished to us can satisfy the stated goals or needs of Poland.

C. An effective financial accounting and disclosure system:

1. Should begin with broad overall accounting concepts which would be made more specific as needed. This would be more efficient and provide flexibility.

2. Should avoid excessive detail which costs too much to administer and lacks flexibility needed in a fast moving economy.

3. Should be broad, not cover just manufacturing enterprises and be supplemented with specific guidelines for particular industries.

We have specific recommendations as to how to proceed and are prepared to assist in the adoption of IAS and to conduct training. A more detailed commentary on accounting is attached as an Appendix.

V. PRIVATIZATION OF STATE OWNED BANKS

A. Privately owned banks will contribute significantly to the vitality of the Polish banking system. To that end, we recommend that the banks in Poland be restructured as rapidly as possible and that several of the restructured banks be privatized.

B. Varied approaches to privatization should be considered and adopted, including management assistance from strong foreign banks, partial and total foreign ownership of Polish banks, partial and total non-state ownership of Polish banks and combinations of these approaches.

VI. NEWLY CHARTERED BANKS; FOREIGN INVESTMENT IN THE POLISH BANKING SYSTEM

A. New banks and foreign investment will accelerate improvements in the Polish banking system.

B. The current policy of encouraging and expediting the chartering of new banks in Poland should be continued, but care should be taken to charter only banks which have a realistic chance of succeeding in a competitive environment. All banks -- new and old, domestic and foreign and state and privately owned -- should be treated equally in all respects.

C. Foreign investment in the Polish banking system should be encouraged by allowing the use of Polish debt in debt-for-equity swap transactions.

VII. TRAINING IN FINANCIAL SERVICES

A. We recommend that programs for training bankers, accountants and lawyers in Poland be established. In the case of bankers, we recommend that the training program supplement existing and planned training programs and that it emphasize management and specialized skills.

B. We recommend expanded programs for training Polish bank managers abroad and for bringing banking experts and specialists to Polish banks to provide on-the-job training.

C. We recommend the establishment of a library of banking, business, accounting and legal reference books and training manuals.

D. We believe that we can obtain cooperation and assistance from leading United States banking institutions and funding in support of the implementation of each of the foregoing recommendations.

VIII. LEGAL STRUCTURE AND REGULATION AND SUPERVISION

A. We have provided some general observations to the National Bank of Poland concerning banking laws and regulations. We believe the existing banking law is not adequate for a non-state banking system. Private enterprise brings with it the need for regulation and supervision of the entrepreneur beyond that required in a state owned system.

B. If Parliament is prepared to delegate adequate regulation-making authority to the National Bank of Poland,

much of the necessary regulation need not be included in the banking law. We suggest that the National Bank of Poland commission a study of the banking laws and regulations of banking systems similar to that to which Poland aspires.

C. We are prepared to provide assistance in connection with the development of the Polish banking law and regulations. In this respect, we have already undertaken to provide materials to legal and supervisory staff of the National Bank of Poland with regard to legal, regulatory, contractual and documentation matters.

IX. CONCLUSIONS

A. We are prepared to cooperate and assist in developing programs, plans and solutions with respect to the matters covered by this report.

B. Because these matters are complex, dealing with them requires a substantial commitment of human, financial and other resources. We recommend that a small working group which includes senior ministerial representatives and representatives of the National Bank of Poland and, importantly, the Polish banking community be selected to participate with us in addressing these matters thoughtfully and constructively, including ways in which necessary funding can be obtained. We are prepared to meet with that working

group promptly and are optimistic about our ability to provide meaningful assistance.

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May 18, 1990

COMPREHENSIVE SYSTEM OF ACCOUNTING

We recommend that the Government of Poland promptly adopt International Accounting Standards ("IAS"). After adoption, accounting professionals must be trained in the new system. The new system is essential for both banks and enterprises if the Government's stated goals for economic liberalization and a free market economy are to be achieved. It is important to understand that adopting IAS does not mean abandoning existing Polish Accounting Rules and Regulations ("PARR"), such as the draft regulation of the Ministry of Finance entitled "Uniform Rules Relating to Double Entry Bookkeeping." It is common for banks and enterprises to be required to provide special detailed reports for regulatory and tax purposes. Until IAS is implemented, the continued use of PARR will provide continuity.

However, it is equally important to emphasize that PARR, without adoption of IAS, is not sufficient. IAS sets a broad framework for users to understand financial statements. The broad framework must be supplemented by guidelines, rules, interpretations and guidance for specific industries in order for the full benefits of the framework to be achieved.

While most countries follow IAS as a broad framework, all have additional detailed rules and regulations. The combination of the broad framework, together with the more detailed rules and regulations that from time to time are deemed necessary by the Government would provide a "Comprehensive Accounting System" ("CAS").

In addition, financial statements that will be issued by Polish enterprises which are privatized will need to be verified or certified as to their accuracy by creditable independent accountants. We were not able to study completely the state of readiness of Polish accountants to meet this challenge; however, our observations and inquiries led us to believe that there will need to be a significant training process in this regard. It is more likely that, at least during the transition period, the major international accounting firms will fulfill this need in Poland. For the longer term, however, it would be desirable for Polish accountants to become familiar with international accounting and auditing standards so that the Polish professional accounting community can gain international prominence and recognition. Development of standards, as well as education and training, are important for this purpose.

We understand that the Ministry of Finance and the Association of Bookkeepers have jointly, in conjunction with the United Kingdom's "Know How Fund" program, solicited proposals from various international accounting firms for the

development of international auditing standards for Poland. Because this project may be expanded to deal with the broader accounting framework issue, coordination is necessary.

The Government also needs to provide prompt transitional guidance to enterprises that are privatizing on a number of issues, including:

1. Impact of inflation on projections and statements.
2. Whether historical or current values should be used.
3. How to adjust compensation and cost of manufacture for pre-privatization worker compensation and taxation.
4. How raw materials and sales should be adjusted for pre-privatization subsidies.

Recommended Actions to Develop Broad Framework

In connection with the transition to a free market economy, we recommend the following:

1. Public announcement of the intention to adopt IAS.
2. Development of a Comprehensive Accounting System, consisting of a broad framework based on IAS supplemented by PARR, for Poland. In this connection it will be necessary to:
 - (a) Compare current Polish Accounting Rules and Regulations to IAS.

(b) Identify areas where PARR and IAS are consistent and adopt and retain relevant portions of PARR.

(c) Identify areas where PARR and IAS differ and determine if IAS is acceptable and if relevant sections of PARR can be modified to conform with IAS.

(d) Identify areas where PARR and IAS differ and IAS is unacceptable for Poland, adopt PARR as consistent or acceptable to IAS and develop guidelines to calculate and disclose in financial statements the differences between PARR and IAS.

(e) Coordinate efforts to adopt IAS and PARR with the efforts of other regulatory and government bodies, such as the Privatization Agency, the Ministry of Finance and the National Bank of Poland, which are in the process of formulating rules.

3. Conformance of privatized enterprises to the new CAS.

4. Development of a program, including prescribed timetables, by which all other enterprises would, in an appropriate way, conform to the new CAS.

CAPITAL MARKETS AND PRIVATIZATION

INTRODUCTION

The Capital Markets and Privatization Team met with officials of the Ministry of Finance (particularly those responsible for privatization and development of a capital market), as well as with officials of the Ministry of Foreign Economic Relations and several members of Parliament. In addition, we participated in a round-table discussion with a group of business and labor leaders. Our concentration, of necessity, was on the capital markets and privatization process.

We were impressed by the ability of those involved and by their thorough investigation of securities activities and regulation in many parts of the world, the level of knowledge attained and the sophistication of their questions and concerns. However, the tasks the Polish Government faces are enormous: no other government has attempted to privatize and create a capital market at the same time.

The Polish Government has determined that these activities are interdependent. We agree. For this reason, we suggest that privatization and the establishment of secondary-market activities be linked as closely in time as possible.

We understand that the Government's schedule envisions that a securities market will be established and operating by January 1, 1991. We believe that this is a very ambitious schedule, primarily because the key elements of a capital market (described below) are not yet in place. Achieving the goal of early 1991 will require very prompt decisions with regard to a broad range of issues and dedication of resources, human and other, to the numerous projects involved.

I. CAPITAL MARKET: ELEMENTS REQUIRED

The capital market that the Polish Government envisions will include corporate equity and debt securities, as well as national and local government debt. In creating this market, certain key elements must be recognized.

A. Elements of a Capital Market

1. Investor Confidence. Most important is investor confidence, which is the essential underpinning of a capital market. The primary and secondary markets must be, and be seen to be, fair to public investors, both domestic and foreign. We believe that the first privatizations should focus equally on process and pricing so as to ensure the successful introduction of the government's economic program. Success begets success, and a positive public image of Poland's securities market will be essential to this success.

2. Accounting. Adoption of internationally accepted accounting principles and auditing standards is fundamental to the establishment of a capital market in which market participants (investors, domestic and foreign, as well as issuers and dealers) will have confidence in the quality, reliability and comparability of financial information. We recommend that the Government announce promptly its intention to adopt such principles and standards (with such modifications as are appropriate in light of Polish circumstances) and that they be made applicable upon adoption to at least those companies in the process of privatization. (See Part IV of the Bank Team's report.)

3. Securities Law. A comprehensive, modern securities law is fundamental to a capital market because it provides a legal framework designed to promote fairness and investor confidence. This subject is discussed in greater detail below.

4. Licensed Dealers. Knowledgeable, financially responsible and honest dealers will be the primary link between the investing public and the capital market. Thus, all companies and individuals dealing in securities with the public in Poland must be required to be licensed. The securities commission to be created pursuant to the securities law will have to establish and implement procedures and standards for such licensing, and an initial group of individuals must be trained and licensed. ^{1/}

^{1/} Part III below sets forth a training proposal.

5. Trading Market. A satisfactory market structure for "secondary" trading of outstanding securities must be established. We recommend the establishment of a Polish securities exchange with the following characteristics:

(a) All licensed dealers should have access to the exchange on reasonable and equivalent terms. The exchange can consist of trading floors in several cities, thus satisfying the need for local access to the market, particularly before a national market linked by an effective communications system is functioning. Trading in all locations should be conducted pursuant to the same rules promulgated by, or approved by, the securities commission.

(b) All trading by licensed dealers in listed securities must be brought to the exchange, at least initially, thus concentrating trading and enhancing liquidity as much as possible.

(c) A market for securities of companies and local governmental units which are not significant enough to require or permit listing on the exchange will develop (an "over-the-counter" market). Dealers should be subject to regulation with respect to the trading of these securities, and consideration should be given to requiring prompt reporting of volume and prices relating to such trading.

(d) The structure of the trading market should anticipate changing needs and opportunities. The Polish exchange itself should be organized, owned and operated in a manner that avoids developing entrenched and vested interests. For example, dealers should not acquire the ability to prevent changes over time in policies or procedures that would benefit Poland generally (such as revised commission rates or trading hours, or an eventual change from exchange floor to computerized trading).

6. Clearance and Settlement.

(a) We recommend that securities in bearer form not be authorized. Trading in bearer securities promotes tax avoidance, disrespect for the tax regime and a sense of unfairness among those who comply with applicable tax laws. Bearer securities also lead to problems of theft and forgery.

(b) We recommend the use of a book entry system for listed securities, if economically and psychologically feasible. The general use of physical securities (which should remain authorized for securities of unlisted issuers) would be cumbersome, be very expensive and interfere with the efficient settlement of market transactions. Poland has the opportunity to start with book entry rather than having to convert to such a system as most countries with sophisticated markets are now attempting to do.

(c) Until the banking system is capable of handling promptly the payments and other elements involved in the settlement of securities transactions, it would be desirable to devise a temporary means for by-passing the banking system for these functions. This could be accomplished by establishing a nonbank facility for settlement of transactions, including book entry registration of securities ownership and transfer and handling of related payments.

(d) The final section of this report contains a comprehensive proposal for a project to establish an integrated securities trading, depositary and clearance system.

7. Tax Regime. A comprehensive review should be made of all taxes and similar charges which are to be applicable to participants, both domestic and foreign, in Poland's capital market. The taxation, if any, of interest and dividends, as well as of capital gains and losses, should be rationalized in light of all policy considerations. Obviously, the lower the tax burden, the more attractive will be the Polish capital market. In any event, we suggest that the Government consider eliminating, or at least reducing significantly, any stamp duties and other taxes on securities trading.

8. Role of Banks. We recommend that the Polish banking system be permitted to participate fully in capital market activities. However, we also recommend that

regulation of securities activities be carried out by the securities commission and not by bank regulators. To facilitate such separate regulation, including the probable imposition of differing capital requirements, consideration should be given to requiring that all securities activities be conducted by separate entities not engaged in banking (perhaps subsidiaries or "sister" companies of the related banks).

B. Securities Law

1. General. As all countries with effective capital markets have recognized, the applicable framework and basic rules for the market must be set forth in an appropriate securities law. The key concern as to any such law is striking the proper delicate balance between under-regulation and over-regulation.

In this respect, other countries' experience teaches several important lessons, including:

- In the absence of required minimum standards of conduct and related penalties (and even in the face of such elements) certain market participants will act improperly.
- The benefits to be derived from including in the law as initially drafted not only those provisions that seem absolutely necessary in light of immediate concerns, but also provisions that, on the basis of experience elsewhere, seem likely to be needed. This comprehensive approach also helps

avoid having to return to Parliament frequently for additional securities legislation.

2. Key Elements of Securities Law

(a) Securities Commission. We concur in the Government's decision to establish a securities commission. This commission should be an independent body composed of members with fixed terms and a staff of experts. It should have broad authority to adapt to changing circumstances by issuing and modifying regulations.

(b) Licensing. Licensing dealers and investment advisors, and of their individual managers and employees.

(c) Self-Regulatory Organization. A self-regulatory organization of dealers and other market participants should eventually participate in the regulatory process. The law should provide for this additional element.

(d) Disclosure.

(i) Provisions governing both prospectuses for direct ("primary") offerings by companies (and probably their controlling stockholders) as well as periodic (annual and interim) reports by companies to their stockholders and the investing public. We recommend that the role of the securities commission in reviewing prospectuses be only to assure that the disclosure

complies with the applicable requirements; the commission should not have the additional power of prohibiting offerings because it disapproves of some aspect of the issuer or offering terms (a power that exists only in a distinct minority of jurisdictions).

(ii) A subject with important disclosure aspects is the status of governmental issuers other than the national government and the National Bank of Poland. A prompt decision should be made as to whether the national government will guarantee the securities of such issuers or will limit issues by such issuers only to those certain to be repaid -- or whether such issuers will retain the same freedom to sell their securities as private companies will enjoy. In the latter situation, we believe that such issuers should be subject to the same disclosure obligations as private issuers.

(e) Collective Investment Undertakings. We expect that in Poland, as in all other major countries, a significant portion of investment by individuals will be made through collective investment vehicles (known in the U.S. as "mutual funds" and in the European Community as "UCITS") -- that is, pools of investor-supplied money invested by professional investment advisors, offering the investor participants the right to purchase and redeem shares on a daily, weekly or other frequent

basis. The securities law should include basic principles governing such entities.

(f) Temporary Prohibitions. We recommend that the law include temporary prohibitions on certain sophisticated types of securities and transactions -- e.g., securities-related futures, publicly traded options and short sales. Prior to removing these temporary prohibitions, the securities commission should believe that such sophisticated securities and transactions are not likely to undermine investor confidence.

(g) Permanent Prohibitions. The law should contain broad prohibitions against trading practices that have come to be universally recognized as inconsistent with fair securities markets, e.g., "insider trading" (transactions in securities based on the unfair use of important nonpublic information) and "market manipulation" (artificial securities transactions designed to create a false public impression of the current market for a security).

(h) Securities Related Credit. The law should authorize the securities commission or another authority to control securities related credit as a means of limiting excessive speculation.

3. Draft Securities Law. The draft securities law previously furnished to the Ministry of Finance by our group is designed to achieve these objectives and implement

our other recommendations. It is not simply a reworked version of United States securities laws. Instead, it is an attempt to distill and customize to the current and foreseeable circumstances of the Polish capital market the best thinking and approaches to securities regulation found today in Western Europe and North America. This forward-looking, synthesized approach is possible, among other reasons, because of a growing convergence (that has accelerated over the last five years or so) as to where securities markets are and are going and as to appropriate regulatory approaches and structures.

C. Other Laws

We recommend that there be undertaken promptly a careful review of existing Polish non-securities corporate and commercial law to determine changes that should be made to facilitate securities transactions. Possible subjects brought to our attention are:

- assurance as to enforceability of oral contracts (e.g., agreements to buy or sell securities made over the telephone between dealers and customers);
- assurance of bona fide purchaser status to persons who have purchased securities in good faith; and
- consideration as to whether dealers should be able to initiate conversations about possible interest in securities transactions with persons not yet their customers (known as "cold calling").

II. PRIVATIZATION

A. Definition

The Polish Government has a wide range of alternative means by which state-owned enterprises can be privatized or otherwise made more responsive to market forces. The term "privatization" itself is used to cover a variety of policies that vary from country to country. Privatization may range from the simple introduction of competitive characteristics into the public sector to the complete sale, through public share offering or divestiture, of a state-owned enterprise.

The privatization strategy employed will reflect objectives that the government seeks to fulfill, some of which may be as follows:

- Increased efficiency through private management;
- Reducing government expenditure required to support state-owned enterprises;
- Obtaining new equity capital for expansion;
- Returning nationalized or expropriated companies to private hands; and
- Contributing to the growth of local equity markets.

In devising the appropriate strategy, it is important to keep in mind, along with the specific government objectives, the particular limitations which are imposed by the country's economy. Simply put, there is no one formula which works in all privatization circumstances. We urge the

Polish Government to develop an overall plan for privatization and to evaluate the privatization candidates individually so that a specific strategy can be defined based on each particular situation.

B. Preparation

In order to maximize the results of each sale, it is essential that the targeted enterprises be properly prepared in advance of the privatization process. There are a number of steps which should be taken immediately. First, the wide range of public companies which are being considered for privatization should be reviewed and rationalized. Given the many thousands of businesses which the Government plans to privatize, there will be some that, if combined with others or broadly reorganized, produce more attractive results from the perspective of proceeds realized, both from their initial sale and from their ongoing business operations.

In advance of privatization, there should also be a review of the financial condition of the targeted entities. Is there debt to be restructured or modified? Is it appropriate to consider an infusion of capital? Are there burdensome legal characteristics or agreements currently in place which adversely affect the targeted businesses' ability to operate effectively? Are there assets or liabilities that should be removed from the entity and retained in the public sector?

C. Management

Management is another critically important issue to be evaluated when considering both the long and short term viability of a particular state owned enterprise. It should be emphasized that privatization can be a catalyst for a management change and improvement. When the privatization methodology being implemented is one which calls for the offering of shares to the public, however, it must be stressed that public shareholders are not likely to be capable of identifying or installing good management. In this circumstance, the Government must undertake the implementation of appropriate management changes. Alternatively, if the privatization approach involves the sale of a major stake to a strategic buyer, such a buyer could be expected to bring capital, technological expertise and management support to the privatized entity.

We also believe the Government should actively consider various forms of incentive programs for management and other employees which are tied to the performance of the companies for which they work.

D. Government Decision-Making

One characteristic common to all successful privatization initiatives is that the government involved clearly, forcefully and promptly identifies the primary government agency with oversight responsibility for program implementation. We believe that the designated agency must have real decision-making authority. Further, it must have

flexibility to respond to changing economic circumstances. Finally, it must be able to act quickly. If the sophisticated international investor community is to be actively encouraged to devote the financial and personnel resources to the full consideration of its investment options in Poland, it must feel as though government decision-making is being effectively and consistently responsive.

E. Foreign Ownership

It is critical for the Government to have a clearly stated policy with respect to foreign ownership. We believe that such a policy should not be too restrictive and that active participation by the international investment community is essential to the success of the privatization program. We believe this to be true, as noted above, with respect to active shareholders; we also believe that significant passive foreign investment will offer numerous advantages, including capital not now existing in the domestic savings pool. Participation of both types of international investors may also serve to validate and encourage the involvement of domestic investors. We also believe that companies having significant foreign ownership interests should, on an on-going basis, receive the same regulatory treatment as companies that are wholly-owned by domestic interests.

We believe that among the privatization options available to the Government, one of the most attractive in some circumstances is the sale of a strategic stake in the

company to a private investor, with a majority interest in the company retained by the Government. After the strategic stakeholder has had an opportunity to effect changes at the company that serve to improve its operating results, the balance of the company then owned by the Government would be offered through a distribution of shares to both domestic and international investors. This multi-step approach serves many purposes. Three which are cited frequently are the following. The first is simply that it provides time to get the enterprise into the best possible shape before it is offered to individual shareholders to insure a sale on the most favorable terms under all the circumstances. Second, it would permit the capital markets to develop more fully before the later public sale. Finally, the retention by the state of some substantial stake would also permit the Government to participate in enhancement of share value over time and minimize criticism that these valuable businesses have been sold at prices which were too low.

F. Use of Proceeds

The Polish Government has many options with respect to the use of proceeds associated with privatization transactions. We make two recommendations in this area. First, we encourage the Government to consider keeping such proceeds outside the normal budgetary process. Second, we think it prudent to reinvest some portion of the proceeds, either in private enterprise generally or more specifically

in a program which would improve the condition of the less attractive enterprises still in the Government's portfolio.

G. Government Guarantee

We are aware of some discussion concerning the desire for a guarantee by the Government of a certain value for privatized shares. We believe that such a guarantee would not be necessary or appropriate. As the Government moves to a more market-oriented economy, investors should be fully and fairly exposed to both the profit and loss potential associated with their investment.

H. Marketing Process

Once all preparation associated with the initial group of companies to be privatized is complete, we believe it is essential that the Government allocate sufficient time to properly and thoroughly market these investments to investors. This is particularly true when foreign investors are targeted. The success of the privatization program will be determined in part by the number of competitive buyers both identified and encouraged to be involved in the bidding process. The identification and cultivation of such investors take time. To shorten this process unduly would simply serve to reduce the proceeds the government will receive from its privatization program.

We strongly support the comprehensive privatization program that the Government is now contemplating. The Government has a difficult challenge in

weighing the various approaches available to it in connection with the privatization process. We would encourage the Government to take the time to properly weigh its options and develop an overall strategy which will maximize the Government's return from the privatization effort.

III. PROPOSAL FOR TRAINING

It is evident that there is a need to provide adequate training for those individual employees of securities dealers who will act in Poland as supervisory and administrative personnel ("principals") and as securities salesmen ("registered representatives"). The training will form an important component of the registration process that will enable the Polish securities commission to license such professionals, thereby authorizing them to begin their professional activities.

We have recommended that the initial stage of the Polish capital market involve only shares and debt securities. The legislation under which all professionals will operate has not yet been finalized, and obviously as yet there are no regulations. Settlement and trading procedures have not been established, nor have standards of conduct.

It would, therefore, not now be feasible to prepare a complete training program for use in Poland. However, it would be possible -- and we recommend -- that a group of 10 to 15 Polish individuals who speak English and who are

expected to fulfill a regulatory role in the licensing process be fully exposed to the training programs used in the United States for registered representatives and principals. Thereafter, these same individuals could be charged with the responsibility for developing training programs in the Polish language consistent with relevant Polish legislation and regulations by then adopted. This could be done in consultation with such outside advisors as may be needed.

It should be possible for these purposes to use significant portions of the United States training programs. For example, the sections on shares and bonds would be usable, as would coverage of quasi-fiduciary duties owed to clients, acceptable sales techniques and compliance. Full use of existing United States programs would not, however, be feasible, because they are too broad (unnecessary product coverage), too complex (they reflect the full spectrum of United States law and regulations), and would not reflect Polish law and regulations as eventually adopted.

The normal United States training program for registered representatives is 12 weeks and is conducted in an office. This provides an opportunity to see and hear business being conducted and to follow transactions from start to finish. Most importantly, this creates the possibility to raise questions with veteran professionals.

The United States principals training course normally lasts four weeks and also culminates in an examination. This training is normally offered to

professionals with several years' experience who have completed a selection process.

Given the ambitious time constraints of Poland's privatization program, it may be possible to reduce the total training period for both programs to 10-12 weeks. It could be offered in the United States or in Western Europe. At the end of this period, there would be a basic group of individuals who could develop training programs in the Polish language and who could assist the securities commission (and eventually any self-regulatory organization) in developing regulations and policies adapted from the extensive range of alternatives which have been developed in the United States.

We believe that funding for this initial training program can be arranged through a United States foundation or the United States financial community.

If this program is acceptable in principle to the Polish government, we would pursue its implementation with the appropriate parties that you designate.

Outline of Potential Principal Subjects
of a Polish Training Program

- I. Nature of a Joint Stock Company
 - A. Statutory provisions
 - B. Structure
 - C. Reporting requirements
 - D. Profit/loss accounting
 - E. Dividends/voting rights/pre-emptive rights

- II. Nature of Debt Securities
 - A. Revenue bonds
 - B. Senior debt
 - C. Convertible bonds

- III. Regulatory
 - A. Securities law
 - B. Securities commission
 - C. Stock exchange(s)
 - D. Commercial code
 - E. Company law

- IV. Compliance Regulations
 - A. Know your customer
 - B. Solicitation - reasonable basis - suitability
 - C. Churning
 - D. Disclosure - public offerings, issuer periodic disclosure
 - E. Best efforts - agency principles
 - F. Principal transactions - conflicts of interest - disclosure

- V. Trading Restrictions
 - A. Insider trading
 - B. Manipulation
 - C. Control persons

- VI. Professional Standards
 - A. Just and equitable principles of trade
 - B. Fairness

IV. PROPOSAL FOR A SECURITIES TRADING, DEPOSITARY AND CLEARANCE SYSTEM

An effective system for executing securities transactions, along with the related machinery and procedures for handling payments and recording changes in ownership, are key elements of a sound infrastructure for a capital market. Accordingly, a high priority of the Capital Markets and Privatization Team was to determine whether, and if so how, these elements can be put in place (along with other aspects of the full capital markets framework) by the Polish Government's stated January 1, 1991 target date.^{2/}

Our preliminary conclusion is that the January 1, 1991 goal will, as to its full operational aspects, be extremely difficult, if not impossible, to meet by anywhere near the suggested deadline without a comprehensive crash program, and may not be possible at all within the time frame specified. If the deadline cannot be met, the cause will be the enormity of the task and the shortness of the time available.

^{2/} The two members of the Team most responsible for this aspect of our recommendations are Robert A. Friedman of Goldman, Sachs & Co. and Kenneth K. Marshall of Coopers & Lybrand. Each has had many years of securities industry operational experience and has observed both the positive and negative experiences of many securities dealers and securities organizations with the installation of computer and other systems in the rapidly changing securities trading and processing environment in the United States and elsewhere.

We propose a program having two phases. Phase I would be a careful preliminary analysis of the processing and staffing requirements, as well as a detailed study of the potential systems solutions available. The work would be undertaken by experienced consultants. The Phase I report would include specific recommendations as to the best solutions possible and the feasibility of an installation in the time frame indicated. The report would also set forth estimates of the costs involved.

If the Phase I report indicates that the project is feasible, we would recommend undertaking a second phase. This would be dependent, however, not only on funding, but on the approval of both an oversight board and on the Polish Government's acceptance of a series of conditions noted below.

If there is a mutual agreement to proceed, Phase II will involve a joint Polish-American mobilization of key people, as well as hardware and software resources, necessary to implement the project. Such resources would include: (1) a United States professional team that would work with the Polish professionals dedicated to the project; (2) an oversight board composed of United States volunteers and Polish officials responsible for the project; and (3) the hardware and software specified in the Phase I study. Phase II would thus involve a Polish-American partnership, where each side would provide the appropriate degree of financial and logistical support necessary to have the project succeed.

The system to be created can be described broadly as an integrated securities trading, depositary and clearance system. It would include a securities trading function, a book entry depositary system to identify the existence and ownership of listed securities and a clearance mechanism that would net settlements among securities trading intermediaries and other parties.^{3/} It is expected that the system will initially be largely manual and later, based on initial experience, fully automated.

This abbreviated description understates the complexity that exists in actually planning and installing such a system, even in countries with well developed capital markets and highly trained operational personnel. Since the communications and payment systems and current state of technology in Poland need significant improvement, it is quite predictable that many problems will be encountered. Consequently, the implementation team will have to focus on necessary manual procedures that may have to be used as a temporary measure.

We anticipate that Phase I will cost between \$250,000 and \$400,000. In order to have any chance of meeting the proposed early 1991 deadline for completion of both phases, the Phase I study (which should take 60-90 days to complete) should be started promptly. In connection with the start of Phase I, a group of Polish professionals,

^{3/} This clearance capability will also be designed to provide customer account maintenance services for those dealers or banks who pay for this service.

including one or more individuals in the Government well informed on policy and given decision making authority, would have to be designated and made available to this project on a full-time basis.

Proceeding with Phase II would be subject to a number of conditions. First and foremost is the result of the Phase I consultants' report indicating whether it makes sense to go forward into Phase II. Second, the approach recommended in the Phase I report, including specific systems, must receive the prompt, full and exclusive endorsement and cooperation of the Polish Government. Third, the designated person or persons in the Polish Government empowered to make decisions regarding the project, as recommended above, must continue to be available on a full-time basis. Fourth, the securities law and related rules and regulations that are adopted must be consistent with the concepts inherent in the proposed solution.

Finally, if Phase II is undertaken, it must be a true partnership effort with both sides providing financial and logistical support.

Assuming that all of these conditions were acceptable and, of course, subject to funding, Phase II would begin. The cost of the remainder of the project would be specified by the Phase I study, but our very preliminary estimate is that its total cost could be around \$10 million.

A final note of caution. Given the very serious communications problems and the state of the banking payments

system, the trading, depository and clearance system that would exist after completion of Phase II -- which would have very powerful ultimate capabilities -- would still be severely restricted and would not begin to approach its full capabilities until the related communications and payment problems were solved. These necessary reservations having been expressed, we approach with great enthusiasm the possibility of helping the Polish Government. Creating the necessary infrastructure is a key element in inspiring confidence of investors inside Poland and throughout the world.

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