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The Hungarian Loan Consolidation Program[1]

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Abstract

After spinning off the commercial banking functions that the central bank had performed for many years into three new banks, post-Communist Hungary faced a severe recession in 1992. The recession led to a high level of nonperforming loans (NPLs) in the banking system. In 1992, the Hungarian government announced a Loan Consolidation Program (LCP) to remove bad debt from the balance sheets of banks on a voluntary basis. Depending on the date when a loan was classified as "bad," the government paid 50%, 80%, or 100% of book value. In 1992, banks transferred bad debt with a book value of HUF 102.5 billion ($1.3 billion) in exchange for HUF 83 billion in special credit consolidation bonds. They transferred an additional HUF 17.3 billion in bad debt at face value in 1993. Even after these transfers, banks still held large portfolios of nonperforming loans to state-owned enterprises. In 1993, the government announced a second, "firm-oriented" LCP to acquire the bad debts of specific state-owned enterprises from banks. Acquisitions under this program totaled HUF 61.3 billion. Rather than create a centralized asset management company (AMC) to manage the two loan consolidation programs, the government used existing state-owned agencies. A portion of the debt purchased under the bank-oriented LCP was sold to a state-owned agency for resolution and disposal; for the firm-oriented LCP, two government agencies were responsible for the management and disposal of acquired bad debt. The government entered into temporary arrangements with the selling banks to continue to manage nonperforming loans until they could be sold. The LCPs temporarily improved bank balance sheets, but high levels of nonperforming loans continued to weigh on bank balance sheets because of the voluntary nature of the LCPs and continued economic deterioration. The government followed the LCPs with a recapitalization program in 1993 and 1994.

Keywords: Hungary, nonperforming loans, transition economy

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The Hungarian Loan Consolidation Program

At a Glance

In 1987, the Hungarian government began to reform the banking system from "one-tier" bank system to a "two-tier" banking system (IMF 1995). The "one-tier" system consisted of a bank for households (Országos Takarékpénztár (OTP) and the National Bank of Hungary (NBH)[3], which had served both central and commercial banking purposes. The Hungarian government spun out three credit departments from the NBH to form three large state-owned commercial banks: the Hungarian Credit Bank (MHB), the National Commercial Credit Bank (K&H), and the Budapest Bank (BB) (Ábel and Bonin 1993a; Nováková 2003; IMF 1995). These banks inherited loan portfolios and customers from the central bank (Ábel and Szakadát 1997).

Summary of Key Terms	
Purpose: "To improve certain financial indicators of troubled commercial banks; to narrow the interest margin; to provide a sound basis for prudent banking activities that would also facilitate the privatization of SOCBs; and to help the reorganization of enterprises" (Ábel and Szakadát 1997).	
Launch dates	Announcement: 1992 (IMF 1995) First transfer: March 1993 (IMF 1995)
Wind-down dates	Not specified at outset
Size and type of NPL problem	17% of banking system loans in 1992 Legacy state-directed loans to state-owned enterprises and new commercial loans
Program size	Not specified at outset
Eligible institutions	Banks with a capital adequacy ratio of less than 7.25% Open bank only
Usage	HUF 181.1 billion ($2.3 billion) transferred in exchange for HUF 155.9.3 billion in government bonds
Outcomes	Bank-oriented LCP: HUF 6 billion recovered by 1997 Firm-oriented LCP: Full write-down on HUF 24 billion, debt for equity swaps of HUF 16 billion
Ownership structure	Government-owned
Notable features	Banks remained responsible for management and disposal of majority of transferred bad debt; no centralized AMC; involved both firm-oriented and bank-oriented loan consolidation programs

Between 1990 and 1993, real GDP in Hungary fell by approximately 20% (Nováková 2003). This severe recession led many of the loans that were transferred from the NBH to become nonperforming. Banking problems were exacerbated by lack of clear regulation, lack of proper supervision, and insufficient experience among bank staff in risk assessment and loan evaluations (Ábel and Szakadát 1997). Furthermore, bank customers tended to be concentrated in specific sectors, because MHB, K&B, and BB were formed from the industrial, food processing, and infrastructure financing departments of the central bank, making the banks vulnerable to the economic recession (IMF 1995).

The Hungarian government passed the Banking Act, which became effective on December 1, 1991, and required banks to reach a capital adequacy ratio (CAR) of 8% by 1994 and to accumulate loan-loss reserves (Ábel and Szakadát 1997). This act also introduced three

[3] The *Magyar Nemzeti Bank* or MNB.

categories for rating loan portfolios. The classification of loans under the Banking Act required that banks classify assets as "bad" if the borrower was in default for more than one year or if the borrower had filed for bankruptcy; these loans required 100% provisioning by 1994. The other two categories of assets that required provisions were "substandard" loans and "doubtful" loans, which required 20% and 50% provisions, respectively. A month later, the government enacted a new bankruptcy law, which became effective on January 1, 1992, requiring any company with any outstanding debt that was more than 90 days in arrears to initiate bankruptcy proceedings "or the responsible parties would be subject to criminal prosecution" (Ábel and Bonin 1993a).

The combination of the recession, the bankruptcy reform, and the new loan classification standards led to a rapid increase in the portion of loans that banks reported as nonperforming, from an estimated 9% in 1991 to 17% in 1992. Credit spreads increased, and viable borrowers began to seek out alternative sources of credit (IMF 1995). Total bank lending decreased, and banks did not have sufficient loan loss provisions (IMF 1995; Ábel and Szakadát 1997).

In 1992, the Hungarian government announced measures to address nonperforming loans. The first measure was the 1992–1993 bank-oriented Loan Consolidation Program (LCP) (Ábel and Szakadát 1997). Banks with a CAR of less than 7.25% were eligible to sell bad debt to the Ministry of Finance (MoF), on behalf of the government, in exchange for government bonds (IMF 1995). Only loans issued prior to October 1, 1992, and classified as "bad" were eligible for transfer to the government. In exchange for the nonperforming debt, the government issued long-term "consolidation" bonds and deducted accumulated risk reserves from the banks (Ábel and Szakadát 1997). Initially, the government issued Series A bonds in exchange for loan principal and Series B bonds for interest arrears and fees, but ultimately replaced Series B bonds with Series A bonds that paid higher interest rates (Várhegyi and Boros-Kazai 1994; Ábel and Szakadát 1997).

Fourteen banks and 69 credit cooperatives participated in the bank-oriented LCP (Ábel and Szakadát 1997). In 1992, the government purchased loans and interest claims with a total face value of HUF 102.5 billion ($1.3 billion)[4] in exchange for a total of HUF 81.3 billion in consolidation bonds (Balassa 1996). Later, in 1993, the government acquired HUF 17.3 billion in additional bad debt at face value from three financial institutions under the LCP (Ábel and Szakadát 1997). The discount on book value for a given asset depended on when the loan was classified as bad: loans classified as bad in 1991 received 50% of face value while loans classified as bad in 1992 received 80% of face value (Ábel and Szakadát 1997). For the debt of certain companies, the government paid 100% of face value (Balassa 1996).

In 1993, the Hungarian government launched a "firm-oriented" LCP program to allow banks to sell debt of large state-owned enterprises (SOEs). The government selected 13 industrial

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[4] In 1992, the average exchange rate was HUF 78.98 = $1 (Ábel and Szakadát 1997

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SOEs and later added eight food processing firms, multiple state farms and agricultural cooperatives, and the Hungarian Railways company. The government purchased debt of industrial and food processing companies at a 10% discount. It purchased debt of Hungarian Railways, state farms, and agricultural cooperatives at face value (Ábel and Szakadát 1997). Similar to the bank-oriented credit consolidation, the government issued consolidation bonds in exchange for the bad loans. Under the firm-oriented LCP, the government exchanged a total of HUF 57.3 billion in consolidation bonds for bad debt with a face value of HUF 61.3 billion (Balassa 1996). (See Figure 1.)

Figure 1. Debt Purchased from Hungarian Banks under the Loan Consolidation Programs

	Book value	**Transfer price**	**Average discount**
1992 Bank-oriented LCP	HUF 102.5 billion	HUF 81.3 billion	21%
1993 Ad-hoc bank-oriented LCP*	HUF 17.3 billion	HUF 17.3 billion	0%
Firm-oriented LCP	HUF 61.3 billion	HUF 57.3 billion	6.5%
Total debt purchased from banks under LCPs	HUF 181.1	HUF 155.9 billion	

**Note: Under the 1993 bank-oriented LCP, the government included three smaller banks in an ad-hoc consolidation process, purchasing HUF 17.3 billion in debt at face value.*

Sources: IMF 1995; Balassa 1996; Ábel and Szakadát 1997.

Though MoF purchased the bad debt, a majority of the debt from the bank-oriented cleanup remained with the selling banks to manage until 1994; the MoF and the selling banks entered into renewable, three-month contracts for the temporary management of the transferred debt (Balassa 1996). The MoF sold approximately HUF 40 billion of debt at face value to the Hungarian Investment and Development Corporation (HIDB), a government-owned entity, and it appears that the loans were sold based on the viability of debt resolution and workout procedures (IMF 1995). The HIDB was responsible for resolving claims with the creditors of the transferred debt, and during the first half of 1993, the HIDB completed agreements with debtor firms—most of which involved reorganizations or liquidations (IMF 1995). Bad debt remaining from the bank-oriented LCP was offered for sale to businesses engaged in the management of nonperforming debt; it appears that HUF 7 billion in bad debt was sold in this manner for a price of approximately 10% of face value. In 1995, the HIDB took over the management of the remaining HUF 63 billion in bad debt and was allowed to retain 35% of the net revenues from the debt recovery (Balassa 1996; Ábel and Szakadát 1997). As of 1997, the total recovery on the bank-oriented LCP totaled approximately HUF 6 billion (Ábel and Szakadát 1997).

Under the firm-oriented LCP, the SOE-related bad debt was transferred to the Hungarian State Holding Company and the State Property Agency (IMF 1995). In 1994, the Hungarian

State Holding Company forgave all of the claims it acquired, which comprised a book value of HUF 24 billion in debt from eight SOEs (IMF 1995; Balassa 1996). The State Property Agency did not have the same legal authority: it swapped HUF 16 billion in debt for equity in SOEs, and then transferred the remaining debt to a new State Privatization and Holding Company (Balassa 1996).

Summary Evaluation

The LCP temporarily improved the balance sheets of Hungarian banks. Bad debt held by banks declined by more than 50%, and bank CARs increased from their prior negative levels (IMF 1995). Despite having positive CARs by Hungarian accounting standards, most Hungarian banks continued to have negative CARs by international accounting standards (Ábel and Szakadát 1997).

The transfer of NPLs to the government in 1993 was not sufficient to stabilize the Hungarian banking system. Despite the transfer of HUF 180 billion in bad debt under the LCP, HUF 352 billion in bad debt remained on bank balance sheets at the end of 1993—a volume similar to that at the end of 1992, prior to the LCP. The LCP was followed by a recapitalization program in 1993 and 1994 because the NPL ratio remained high.[5] The LCP also failed to address operational and organizational issues within the banks. The recapitalization program required that banks enter into a consolidation agreement with the government which would specify plans for reorganization and debt resolution (IMF 1995).

In 1995, the IMF noted that it was "not difficult to make the case that the 1992 LCP promoted expectations among the banks of further bailouts in the future" (IMF 1995). Because the LCP was voluntary, banks withheld a number of bad loans that were eligible for transfer. It appears that at the time of the bank-oriented LCP, banks expected that the government would pay a higher price on bad debt from SOEs, as proved the case in the firm-oriented LCP (IMF 1995). Furthermore, the decision to temporarily contract out the management of debt to the originating banks "had no effect whatsoever on either the enterprises concerned or on the recovery of the claims" because the banks did not have the opportunity or incentive to enter into negotiations with the debtor companies (Balassa 1996).

Balassa (1996) calls some of the Hungarian government's actions "insufficiently considered, suboptimal or absolutely *mistaken steps.*" He argues that the missteps increased the total cost of the bank system restructuring and estimates that the total cost could have been up to 25% less than the actual cost. Beyond the ineffectiveness of the initial LCP at addressing the stock of problem loans, he noted that the public viewed the LCP as a "gigantic income transfer at the expense of society, the citizens and businesses in favor of the banks, moreover, of the bankers."

Scholars have noted that the initial structure of the consolidation bonds, specifically the Series B bonds, was unattractive for a number of reasons. Series B bonds were issued in

[5] For more information about the bank recapitalization program, see: Oguri, Junko. Forthcoming 2021. "The Hungarian Bank Recapitalization Program 1993–1994." *Journal of Financial Crises*.

exchange for interest arrears and fees and comprised approximately one-third of the transferred debt. However, these bonds were scheduled to pay only half of the market interest rate. These features put the banks that participated at a "distinct disadvantage" in the long-term and reversed positive balance sheet effects. The government ultimately decided to swap the Series B bonds for Series A bonds (Várhegyi and Boros-Kazai 1994).

Another consideration in designing and implementing such interventions is timing and the length of planning. Várhegyi and Boros-Kazai (1994) noted that the loan consolidation proposal underwent multiple modifications before it was finalized in March 1993. Balassa (1996) noted that the Hungarian government delayed decision-making for how to address the increasingly urgent NPL problem and was eventually "pressed for time" The "lengthy multi-stage procedure" is considered to be a factor in the higher cost of the banking system restructuring (Ábel and Szakadát 1997). The prolonged timeframe also contributed to "moral hazard of various agents," which Ábel and Szakadát (1997) argue could have been avoided without the multiple stages to the banking system restructuring.

The Hungarian Loan Consolidation Program (LCP): Hungary Context	
GDP (SAAR, Nominal GDP in LCU converted to USD)	\$33.4 billion in 1991 \$37.3 billion in 1992 \$38.6 billion in 1993
GDP per capita (SAAR, Nominal GDP in LCU converted to USD)	\$3,219.77 in 1991 \$3,597.11 in 1992 \$3,726.83 in 1993
Sovereign credit rating (5-year senior debt)	Data not available in 1991–1993
Size of banking system	\$28.2 billion in 1991 \$28.9 billion in 1992 \$28.6 billion in 1993
Size of banking system as a percentage of GDP	84.4% in 1991 77.3% in 1992 74.1% in 1993
Size of banking system as a percentage of financial system	Data not available in 1991–1993
5-bank concentration of banking system	41.5% in 1991 43.7% in 1992 42.7% in 1993
Foreign involvement in banking system	14.7% in 1991 15.3% in 1992 28.0% in 1993
Government ownership of banking system	90% majority ownership in 1990 27% majority ownership in 1995
Existence of deposit insurance	Yes in 1991–1993
Sources: Ábel and Szakadát 1997; World Bank Population Data; IMF 1995; Orszagos Betetbiztositasi Alap (National Deposit Insurance Fund of Hungary); author's calculations.	

Key Design Decisions

1. **Part of a Package: The Hungarian government implemented the loan consolidation program (LCP) in 1992 and 1993 after adopting new banking and bankruptcy legislation; however, the LCP proved insufficient to address the solvency issues at the banks, and the government recapitalized banks in 1993 and 1994.**

Prior to the implementation of the LCP, the Hungarian government passed three laws that amended and established requirements related to banking, bankruptcy, and accounting standards. The Banking Act of 1991 required banks to provision for loan losses and achieve a CAR of 8% by January 1994. The Accounting Act of 1991 required that companies prepare financial statements that conformed with International Accounting Standards (Ábel and Szakadát 1997). The Bankruptcy Act of 1991 set an automatic trigger for bankruptcy, requiring firms with debts more than 90 days past due to initiate bankruptcy (Nováková 2003). These regulatory changes revealed the high level of NPLs in Hungary and had an "unprecedented impact on the financial sector" (Ábel and Szakadát 1997).

At the end of 1991, the government issued guarantees to banks for a portion of the loans transferred as part of the 1987 financial sector reform; these loans were increasingly deteriorating in quality. The guarantees covered loans that had been extended primarily to the state-owned coal mining sector, with a total of HUF 10.5 billion in debt at face value covered by the government guarantees. The measure proved insufficient to address the full scope of banking sector problems—many inherited loans were nonperforming, and banks continued to lend in an "imprudent" manner because of the possibility of a future recapitalization or government guarantee (IMF 1995).

In 1992 and 1993, the Hungarian government adopted both a bank-oriented LCP and firm-oriented LCP to address the prevalence of nonperforming loans and weakness in the banking sector (Balassa 1996). For the firm-oriented program, the debt of certain state-owned enterprises (SOEs) was eligible for exchange; this program was not directly targeted at the banks, but banks were an indirect beneficiary as the government purchased eligible SOE debt from the banks (Ábel and Szakadát 1997). Beyond the consolidation programs, the government took resolution and restructuring action for three banks in 1993 (Balassa 1996; Ábel and Szakadát 1997).

Despite removing NPLs from the banking system, the Hungarian banks continued to experience high levels of NPLs, and the Hungarian government followed the LCP with a recapitalization program in 1993–1994 (Ábel and Szakadát 1997). Under the recapitalization program, a bank received capital from the government on the condition that it entered into an agreement (a consolidation contract) regarding plans for reorganization and debt resolution (IMF 1995).

2. **Legal Authority: The annual budget laws provided the authority to issue consolidation bonds, but the Hungarian government did not pass laws authorizing or governing the LCP or subsequent restructuring of the banking system.**

Legal authority for NPL acquisitions came from government resolutions and the annual budget laws that provided for the issuance of consolidation bonds (Balassa 1996). Specifically, the 1993 budget law authorized the government to issue the credit consolidation bonds (Bonin and Schaffer 1995).

According to Balassa (1996), the government "would have been warranted to specify the goals and rules of the entire [bank restructuring] process in the form of a law enacted by Parliament." However, the government did not submit a bill, and Balassa attributes it to factors including "the uncertainties in forecasting the dimensions of the entire series of actions, the step-by-step evolution of the methods applied, the technical complications of the matter and the rightful concern that the preparation and discussions of the bill would take so long that the necessary measures would not have been possible to implement."

3. **Special Powers: The Hungarian government did not provide special legal authority related to debt collection or recovery, but one of the government agencies received ex post legal authority to forgive its full portfolio of LCP debt.**

The LCPs differ from other AMC-type interventions because the government did not establish a centralized resolution agency. The Hungarian LCPs were administered by the MoF, which did not receive special legal authority. A portion of the bank-oriented LCP debt was sold to the state-owned Hungarian Investment and Development Bank (HIDB) which did not appear to have special legal authority. For the firm-oriented LCP, the two state-owned agencies—the State Property Agency (SPA) and the Hungarian State Holding Company (HSHC)—were responsible for resolution and disposal of the debt purchased by the state. The HSHC forgave all of the outstanding claims against the eight companies within its portfolio, but the MOF legalized this action only after it occurred. The SPA did not have such legal authority because of its status as a budgetary agency, and thus used other methods to resolve the debt (see Key Design Decision No. 13 on recovery and disposal) (Balassa 1996).

4. **Mandate: The purpose of the LCP was to acquire bad debt from Hungarian banks, but the government did not announce a specific mandate related to minimizing losses or maximizing recovery.**

The Hungarian government intended for the LCP to transfer bad debt off the balance sheets of Hungarian banks. The HIDB, SPA, and HSHC were established independently of the LCPs, but these agencies were responsible for the resolution of a portion of the LCP debt. These agencies had separate purposes and resolution methods available to them. For example, the HSHC forgave its entire portfolio of debt from the firm-oriented LCP. Under the firm-oriented LCP, enterprises were chosen based on their strategic importance: the government considered their "survival for reasons of 'industrial policy' as necessary" despite their indebtedness. These companies were also considered important from an employment policy standpoint (Balassa 1996). Therefore, an important consideration in the resolution of debt under the firm-oriented LCP was ensuring the survival of these strategic enterprises.

5. **Ownership Structure: The government did not establish a centralized AMC; rather the government acquired the bad debt and later sold a portion of the bad debt to one of three government-owned entities.**

The Hungarian government rejected proposals for a centralized asset management agency—multiple government agencies including the MoF, NBH, and the State Banking Supervision (SBS) objected to the proposal for a centralized AMC. According to Balassa (1996), the reasons for objections included the predicted difficulty in staffing such an agency, the threat that the agency would have forgiven the debts, and the concern that the method would not utilize the existing knowledge and relationships of the banks.

The Hungarian LCP differs from traditional AMCs because the majority of bad debt purchased by the government remained with the banks for resolution, at least in the short term. A portion of the bad debt purchased by the Ministry of Finance from the Hungarian banks was sold to the Hungarian Investment and Development Bank (HIDB), which was fully owned by the government (Ábel and Szakadát 1997).

Under the firm-oriented LCP, the government transferred the acquired debt to the Hungarian State Holding Company and the State Property Agency, both of which were government-owned property management companies (Balassa 1996).

6. **Governance/Administration: The Ministry of Finance was responsible for the administration of the LCP and sold portions of the debt to other government-owned agencies.**

The Hungarian MoF was responsible for the administration of the LCP, and the HIDB was able to purchase a portion of bad debt under the bank-oriented LCP. For the firm-oriented LCP, the government transferred SOE-related bad debt to the Hungarian State Holding Company and the State Property Agency.

As a part of the acquisition process, a state agency was responsible for confirming that the banks had classified the loans that were to be transferred properly (Balassa 1996).

7. **Size: The Hungarian government did not announce a maximum program size prior to launching the LCP.**

The Hungarian government did not announce a predetermined size for the LCP. Banks could voluntarily and independently determine which loans they wanted to sell to the government, and prior to the program launch, banks sought to remove HUF 150 billion from their balance sheets (Ábel and Szakadát 1997). However, the government ultimately purchased bad debt with a book value of HUF 102.5 billion in exchange for HUF 81.3 billion in consolidation bonds in 1992. In 1993, the government purchased an additional HUF 17.3 billion in bad debt from banks at face value; therefore, the total book value of debt purchased from Hungarian banks under the bank-oriented LCP was HUF 120.5 billion, in exchange for approximately HUF 100 billion in consolidation bonds. Under the firm-oriented LCP, the government purchased a book value of HUF 61.3 billion in bad debt in exchange for HUF 57.3 billion in consolidation bonds (Balassa 1996).

8. **Funding Source: The Hungarian government funded the acquisition of bad debt under the LCP.**

According to Balassa (1996), the Hungarian government had two options for assuming the financial burden of the banking system restructuring: either pay in cash or use government securities. At the time, the Hungarian government would not have been able to use cash unless it received a loan from a multilateral institution, such as the International Monetary Fund or World Bank, but the government was not able to receive a loan from such an institution. Therefore, issuing government securities was the only available funding source for the consolidation program. Consolidation bonds, which were transferred in exchange for bad debt, were authorized under the state budget law and increased the state debt (Ábel and Szakadát 1997; Balassa 1996).

9. **Eligible Institutions: Domestic banks with CAR of less than 7.25% were eligible to participate in the bank-oriented program on a voluntary basis, while banks holding debt from a specific list of SOEs were eligible to voluntarily participate in the firm-oriented LCP.**

For the bank-oriented credit consolidation, domestic banks with CAR of less than 7.25% as of the end of 1992 could participate. A total of 14 banks and 69 savings cooperatives participated in the credit consolidation (Ábel and Szakadát 1997).

The firm-oriented credit consolidation program did not specify the eligible financial institutions; rather, there was a government-identified list of eligible SOEs for which it would purchase outstanding bank debt in exchange for consolidation bonds.

10. **Eligible Assets: Loans issued prior to October 1, 1992, that were classified as "bad" were eligible for voluntary transfer under the bank-oriented LCP; debt from a government-specified list of SOEs was eligible for voluntary transfer under the firm-oriented LCP.**

Eligible domestic banks could sell loans that were classified as "bad" that had been issued prior to October 1, 1992 (IMF 1995). From these loans, the bank could choose which loans to transfer—the LCP did not require that banks transfer all such assets to the government. Housing loans, consumer loans, and loans to foreigners or financial institutions were not eligible for transfer under the LCP (Ábel and Szakadát 1997).

In setting the time-based criteria for the loans, the MoF elaborated on its rationale, noting that including more current loans would have increased moral hazard, "stimulat[ing] the banks to be irresponsible in their lending policies" (Ábel and Szakadát 1997). Therefore, the MoF sought to mitigate moral hazard risks when it set the criteria for eligible assets.

For the firm-oriented LCP, the government determined a list of specific firms whose outstanding debt was eligible for purchase. These included Hungarian Railways (MÁV), 13 industrial SOEs, eight food processing firms, and several agricultural cooperatives and state-owned farms (Ábel and Szakadát 1997). These firms were considered "strategic" to the economy and designated as "privileged enterprises," as the government considered their survival to be necessary even though the firms were heavily indebted (Balassa 1996).

11. Acquisition – Mechanics: In exchange for the transfer of bad debt, the government issued credit consolidation bonds to the banks and ultimately removed the initial distinction between bonds exchanged for principal and bonds exchanged for interest arrears and fees.

In exchange for bad loans, the government issued consolidation bonds. Under the bank-oriented LCP, bond issuance totaled nearly HUF 100 billion while the total bonds issued under the enterprise-oriented LCP totaled HUF 57.3 billion (Balassa 1996). Initially, there were two types of bonds: Series A and Series B. Series A bonds were issued in exchange for principal while Series B bonds were exchanged for interest arrears and fees. The Series A bonds paid a market-based interest rate, had a 20-year maturity, and were freely negotiable (IMF 1995). Series B bonds, which were planned to pay only half of the market interest rate, were later converted by the government into Series A bonds (Ábel and Szakadát 1997; IMF 1995). Initially, as part of the Series B bonds, the government planned to impose a consolidation fee on the banks, which would have decreased the interest income stream by 50%, but the government ultimately removed the consolidation fee by converting the Series B bonds to Series A bonds (Ábel and Szakadát 1997).

12. Acquisition – Pricing: Depending on the date of classification, the transfer price was either 50 or 80% of face value, though some debt was purchased at 100% of face value.

The government exchanged consolidation bonds for loans classified as "bad" as of the end of 1992. The purchase price was dependent on when the loan was classified as bad:

- For loans classified as bad *before* 1992, the government paid 50% of face value;
- For loans classified as bad *in* 1992, the government paid 80% of face value (Balassa 1996).

The discounted portion of debt was charged against the banks' provisions (IMF 1995).

In certain cases for specific debtor companies, the government paid 100% of face value (Balassa 1996). For example, debt that had been guaranteed by the government and debt that was held from a company that was restructured by the State Property Agency or the State Assets Holding Company could be transferred for 100% of face value with the approval of the MoF (Ábel and Bonin 1993).

13. **Management and Disposal: The majority of the debt transferred under the bank-oriented LCP remained under the management of the originating bank under temporary contracts with the MoF, though a portion was transferred to a government-owned agency, while the debt transferred under the firm-oriented LCP was transferred to one of two government owned-entities.**

The Ministry of Finance sold HUF 40 billion in face value of bad debt from the bank-oriented LCP to the Hungarian Investment and Development Bank (HIDB) for management. The HIDB opted to purchase the debt from companies "whose reorganization and improvement seemed promising" and ultimately acquired debt from 56 enterprises. The HIDB had three options for resolution or disposal: debt-to-equity conversions, debt rescheduling, or debt forgiveness. Of the claims purchased by the HIDB, 95% were against companies under liquidation. Overall, 19 companies were successfully reorganized (Balassa 1996).

For the remaining debt, the Ministry of Finance entered into three-month contracts with the selling banks where the bank remained responsible for the management of the debt. These contracts were renewed every three months through the middle of 1994 (Balassa 1996). The MoF offered the remaining debt for sale to companies that engaged in the management of bad debt, but only a small portion (HUF 7 billion) was sold in this manner (Balassa 1996; Ábel and Szakadát 1997). In 1995, the HIDB began to manage the remaining HUF 63 billion in debt on behalf of the MoF (Balassa 1996; Ábel and Szakadát 1997). The HIDB was allowed to retain 35% of the net revenue on the recovery of the remaining debt. As of 1997, the total recovery on the bank-oriented LCP totaled approximately HUF 6 billion (Ábel and Szakadát 1997).

For the firm-oriented LCP, the government transferred nonperforming loans to the Hungarian State Holding Company and the State Property Agency (IMF 1995). In 1994, the Hungarian State Holding Company forgave all HUF 24 billion in debt at book value that it acquired from eight SOEs (IMF 1995; Balassa 1996). This blanket forgiveness was initiated despite the lack of viable reorganization plans, and it was legalized ex post by the MoF (Balassa 1996). Because the State Property Agency would have required parliamentary approval to forgive debt, it swapped HUF 16 billion in debt for equity and then transferred the remaining debt to the newly established State Privatization and Holding Company (ÁPV Rt.) (Balassa 1996; Ábel and Szakadát 1997). It is not clear how the ÁPV Rt. managed, disposed, or recovered its portfolio of debt.

14. Timeframe: The bank-oriented LCP launched in 1993, but it does not appear that the government specified a deadline for the resolution of the transferred bad debt.

It does not appear that the Hungarian government specified a timeframe for the LCP or a deadline for NPL resolution. The Hungarian government discussed proposals to clean up bank balance sheets in 1992 and announced the final version of the program on December 29, 1992. The proposal was later "'refined'" by the Minister of Finance on March 8, 1993 (Várhegyi and Boros-Kazai 1994). The government entered into a fixed contract with banks on March 16 and began operations of the LCP at that time (Várhegyi and Boros-Kazai 1994; Ábel and Bonin 1993). The firm-oriented LCP launched in the fourth quarter of 1993 (IMF 1995).

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