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## **SPI Albania Project on Revising the Debt Contracting Regulatory Framework July 2009**

### **Note on Advisory, Technical and Other Supporting services associated with Albania's debt borrowing**

#### **Context**

In Albania obtaining loans from private banks (foreign and domestic) for the Government is subject to public procurement procedures pursuant to Article 26 of the State Borrowing Law no. 9665 dated 18.12.2006. However, advisory, technical and other supporting services related to debt contracting not only are not subject to public procurement rules, but they are also excluded from the jurisdiction of the law no. 9643 dated 20.11.2006 on Public Procurement (article 7), with the exception of legal services<sup>1</sup> which are provided for in the Public Procurement Law.

The Government has expressed its concern for this gap in the legal framework that can create difficulties for them in cases when they would like to borrow from commercial banks (such as the recent cases of syndicated loans). They have addressed this concern to the SPI Albania (after having raised it also with other IFIs), *First* to get a clear information on the best international practice in these cases, and *Second*, based on that, to prepare proposed revisions of the relevant legal framework.

Foreign borrowing has gained momentum due to the access the country has gained to international financial markets. It is also the Government strategy to reduce domestic borrowing and increase foreign borrowing as outlined in the Public Debt Strategy for 2008-2010.

Until 2007, Albania has contracted foreign official debt from international organizations like the World Bank, European Bank for Reconstruction and Development, European Investment Bank, Islamic Development Bank etc. and governments of various countries. Selection of creditors has not been conducted following public procurement rules, but in the case of the IFIs, it was based on the relevant Legal Agreements and Membership, whereas in the cases of bilateral donors, it has been based on the bilateral Agreements, always in the framework of the overall development strategy of the Albanian Government (i.e. PRSP/NSSED/ NSDI). As the debt for the most part was under soft terms, its borrowing cost was not very high.

After receiving country rating by Moody's, Albania was allowed to begin contracting debt in international capital markets. In 2008 the government contracted its first syndicated loan<sup>2</sup> from domestic and foreign banks under commercial terms. In 2009 the government contracted another

<sup>1</sup> In the ToRs prepared for this project, other supporting services include but are not limited to legal services.

syndicated loan assumed by two co-leading banks that have agreed to arrange a loan for the amount up to Euro 250 million.

Contracting syndicated loans or issuing government securities like Eurobonds<sup>3</sup> in international capital markets are complex processes, include many more stakeholders than the previous loans contracted from international organizations. In order to contract such kinds of borrowing the Government must undertake preliminary technical steps that are the object of Advisory, Technical and other Supporting Services that are going to be analyzed in this note.

## **Implications**

The gap identified in the legal framework may have negative consequences for the Ministry of Finance in contracting debt such as:

- Delays in contracting debt, as the analysis is to be handled with internal limited resources, with results on liquidity and costs;
- Increase in the transaction cost risk due to limited in-house analytics capabilities

The situation may hamper also banks and investors from offering the necessary financial services.

## **Scope of Analysis**

The purpose of the note is to enumerate and provide information on advisory, technical and other supporting services related to debt contracting relying on the literature and current experience of the Ministry of Finance and commercial banks acting as their agents. The most important argument for providing such information is that the exemption clause of public procurement law regarding “*financial services related to purchase, sale or title transfer or other financial instruments*” neither does provide any definition for these services nor enumerates them. Therefore, getting a clear understanding of the advisory, technical and other supporting services would help authorities determine the degree of regulatory intervention (amending relevant legal framework) as well as provide concise and clear clauses for the services in question.

This note was prepared by: (i) consulting the literature, (ii) based on meetings with individual members of the working group of the project in question. It makes also reference to the recent Albanian legislation in defining the advisory, technical and other supporting services.

## **I. Advisory, technical and other supporting services**

We can classify these services into three big categories:

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<sup>2</sup> Wikipedia: By definition a syndicated loan is one that is provided by a group of lenders and is structured, arranged and administered by one or several commercial or investment banks known as arrangers.

<sup>3</sup> Wikipedia: By definition a bond is a debt capital market instrument issued by a borrower who is then required to repay to the lender/investor the amount borrowed plus interest over a specified period of time

## **A. Services prior to debt contracting**

**A.1. Services falling under this category relate to contracting debt from private banks.** After the Ministry of Finance has expressed interest in contracting debt from banks or investors, it must at the same time express interest for selecting the Bank that would arrange the loan to be granted, which is realized by the issuing of a letter of credit<sup>4</sup> available for all life validity of the loan. The selected agent Bank/s will benefit a fee which is paid by the Ministry of Finance with the funds of the state budget for the service provided.

In some circumstances, the Ministry of Finance may also need to identify a guarantor of the debt to be issued, in full or in part.

As mentioned above, starting from year 2007 Albania has been allowed to contract debt in international capital markets. One of the debt instruments is Eurobond which has not been issued yet due to global financial crisis and the difficulties to get access to capital markets.

Other advisory, technical services include those services which are provided to the Ministry of Finance from an independent evaluator/consultant to help assess costs, risks when the bids have been received by the lenders.

**A.2. Other supporting services** related to debt contracting are mainly (but not limited only) legal services offered to the Ministry of Finance with regard to the foreign law that applies- mainly English law- in international agreements to resolve the disputes.

According to the literature<sup>5</sup> investors and borrowers in the Eurobond market may at one time fall under the auspices of a number of countries laws and regulations. The most important legal considerations relate to: (i) the possibility that the bonds are eventually distributed to residents in the United States and (ii) London, as the principal financial centre where the sale and trading of bonds takes place. The first consideration means that the market is subject to legislation in the US that dates from 1993<sup>6</sup>. The second consideration means that the market comes under certain aspects of English law.

The legal advisor will assume responsibility for the legal issues involved in the issuing Eurobond transaction. Even in this case the Ministry of Finance may be required to contract an independent consultant with experience in this field to make the assessments and referral to the English law and Albanian law so that confusions are avoided.

## **B. Services post debt contracting**

Services falling under this category relate to the debt management.

After the Ministry of Finance has entered into an agreement with the lender in order to start the implementation of the project the condition is that the agreement must be effective. In most cases

<sup>4</sup> Wikipedia: A standard commercial letter of credit is a document issued mostly by a financial institution which provides an irrevocable payment undertaking

<sup>5</sup> Choudhry, Moorad, The bond and money market, <http://books.google.com/books?id=1h733yvfnbcC&pg=PA377&lpg=PA378&ots=-ACNotYtkU&dq=issuing+eurobond>

<sup>6</sup> The US Securities Act of 1993

one of the conditions of implementing the project is selection of the agent Bank for the Albanian side, which will facilitate the loan administration through connecting with the agent Bank of the lender for the purpose of obtaining the loan amount. In the case of Eurobond, advisory, technical and other supporting services include selecting of the fiscal agent whose main responsibilities are to pay interest and principal payments and to perform a number of administrative role, as well the publication of financial information and notices to the investor<sup>7</sup>.

Until now, these services are offered by domestic banks without any cost, (it refers to the normal transaction cost which has been paid by project account) and thus the selection of the Bank has been flexible for both sides.

Specifically, the selection made so far is based on:

- the experience that banks have had in providing these kinds of services;
- the reliability and reputation of the Bank in the domestic and foreign financial market;
- the Bank's financial situation and accuracy and correctness in delivering these services in favor of the Government of Albania.

Being that these kinds of services have not affected the state budget, the Ministry of Finance has been more flexible in this process. In general they affect the budget, because it is borrowing anyway, even if in soft terms. The real issue is that, since it had been regulated by the donor's procedures, the government had been more comfortable. In the case of commercial borrowing, the Government is more exposed to the risk of transacting at unfavorable conditions.

### **C. Services related to the Country Credit Rating**

Services belonging to this category are Advisory, technical and other supporting services that are provided by specialized international credit rating agencies such as Moody's or Standard & Poor and that relate to the sovereign rating given to the country regarding its economy and the repayment ability of the Government for its obligations taken over in the framework of government borrowing.

Sovereign ratings are used by governments to raise capital to finance national debt. They allow the government to secure additional funds at more competitive prices. In 2007 the international rating agency Moody's gave the country its first-ever sovereign ratings Ba1 for foreign-currency bonds and a B1 for the government's debt obligations<sup>8</sup>.

## **II. Advisory, technical and other supporting services as defined in the Albanian Legislation**

According to the Stabilization and Association Agreement, annex IV a financial service is meant to include any service of any financial nature offered from a financial service provider to a party.

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<sup>7</sup> Choudhry, Moorad, The ibidem

<sup>8</sup> [http://www.setimes.com/cocoon/setimes/xhtml/en\\_GB/features/setimes/features/2007/08/16/feature-02](http://www.setimes.com/cocoon/setimes/xhtml/en_GB/features/setimes/features/2007/08/16/feature-02)

The SAA agreement does not set any particular definition of advisory, technical and other supporting services related to debt contracting (please refer to annex). According to this agreement in the definition of financial services among others it is included any activity that relates to giving loans of all kinds, all payments and money transfer services, as well as consulting, mediating and other services that accompany all bank services. Thus, there is not any distinction made for consulting and other services that accompany bank services when using the term “financial services”. They all fall under same category of “financial services”.

According to the article 54 of the Law “On banks in the Republic of Albania” no. 9662 dated 18.12.2006, same can be said about advisory, technical and other supporting services related to debt contracting where no specific definition is provided for said services (please refer to annex). According to the this law the term used for financial service is instead “financial activity” in whose definition among others it is included lending of all types, all payments and money transfer services, guarantees and commitments, as well as advisory, intermediation and other auxiliary services that accompany all bank activities.

## **Conclusion**

The range of advisory, technical and other supporting services related to debt borrowing is very diverse due to the fact that the financial sector is a dynamic one with products which are becoming more and more sophisticated. As was mentioned earlier in this note, the Albanian Government has already entered the phase of contracting syndicated loans and is allowed to issue Eurobonds. Sophistication of financial instruments will grow hand in hand with the sophistication and diversity of their associated. Consequently, it may be difficult to determine accurately and conclusively all services associated to debt borrowing in addition to those mentioned in this note.

## **Recommendations**

Considering that the advisory, technical and other supporting services associated to debt borrowing are not provided for in any legislation in Albania and due to the very large range of these kind of services, it is recommended that the relevant legal regulation includes a general provision covering their contracting by the Government.

The services listed in this note could be attached to the legal provision for illustrative purposes. It is recommended that the list of services be amended with new services introduced and identified by authorities from time to time.

## Annex

### **Advisory, technical and other supporting services as defined in the Albanian Legislation**

According to the Stabilization and Association Agreement, annex IV, a financial service is meant to include any service of any financial nature offered from a financial service provider to a party.

According to this agreement these services include all insurance and insurance related services and bank services and other financial services (excluding insurance). For the purpose of this note reference is made only to bank services and other financial services which are the following:

1. Acceptance of deposits and other public re-payable funds;
2. giving loans of all kinds, including inter alia, consumer's crediting, mortgage crediting, production and financing of trade transactions;
3. taking loans in monetary value;
4. all payments and money transfer services, including crediting, price and debit cards determination, travel check and bank drafts
5. guarantees and engagements
6. trading for personal or clients purpose in the currency market, in the decentralized market or in another form such as:
  - (a) currency market instruments (checks, invoices, deposit certificates etc)
  - (b) foreign transactions
  - (c) derivative products which include but are not limited to predetermined contracts and options
  - (d) exchange values and interest valuation instruments, including such products as exchanges , future interest value determining agreements etc
  - (e) titles with transferring value
7. taking part in all insurance issues, including agreeing and becoming an agent and insuring services related to such issues
8. management of assets such as currency or portfolio's management, all forms of collective investment management, pension funds management, taking into custody, depositing and good faith services;
9. choosing and clarification of financial assets services, including titles, derivative products and other negotiable instruments;
10. financial data acquisition and transfer and financial data and related programs processing from other financial services providers
- 11. consulting, mediating services and other services related to those listed in points (1) –(10) above, including crediting reference and analyze, investment and portfolio search and consulting on gains and on company's re-structuring and strategy.**

According to Stabilization and Association Agreement, Annex IV, the following activities are excluded from the definition of financial services:

- (i) activities performed by central banks or any other public institution in accordance with monetary and exchange policies;

(ii) activities performed by central banks, government agencies or departments, or public institutions on behalf of or on government guarantee, excluding those activities that may be performed by financial services insurance subject in concurrence with other public entities;

From the banking perspective financial activity is defined in article 54 of the Law “On banks in the Republic of Albania” no. 9662 dated 18.12.2006. According to paragraph 2 of this article the following shall be considered as financial activities:

1. Lending of all types including inter alia, consumer credit, mortgage, factoring and financing of commercial transaction
2. Leasing
3. All payments and money transferring services, including credit, charge and debit cards, travelers, cheques, bankers draft;
4. Guarantees and commitments
5. Trading for own account or for the account of clients, whether on a foreign exchange, in an over-the-counter market or otherwise the following:
  - (i) money market instruments (cheques, bills, certificates of deposit etc)
  - (ii) foreign exchange
  - (iii) derivative products, included, but not limited to futures or options;
  - (iv) exchange rates and interest rate instruments including products such as swaps and forward agreements;
  - (v) transferable securities
  - (vi) other negotiable instruments and financial assets including bullion;
  - (vii) participation in issues of all kinds of securities including, underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues;
6. Money broking
  - (i) asset management such as cash or portfolio management, fund management, custodial, depository and trust services;
  - (ii) settlement and clearing services for financial assets, including securities, derivative products and other negotiable instruments;
  - (iii) provision and transfer of financial information and financial data processing and related software by providers of other financial services
7. **advisory, intermediation and other auxiliary financial services of all activities listed in points (1) – (6) above, including credit reference and analyses, investment and portfolio research and advice, advise on acquisitions and on corporate restructuring and strategy.**

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Memo on State Borrowing and Public Procurement Procedures prepared by the Legal Studio Kalo and Associates-Tirana Office on 19 June 2009