



Draft prepared by
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“Scoping of Problem” Document

Project: Revising the Debt Contracting Regulatory Framework

Section 1 Project information

PUBLIC-PRIVATE FINANCIAL SECTOR MODERNIZATION MATRIX					
Italian Banking Association CRITERIA	European Central Bank CRITERIA				
	<i>Asymmetric information reduction</i>	<i>Completeness of the market</i>	<i>Increased opportunities to engage in financial transactions</i>	<i>Reduced transaction costs</i>	<i>Increased competition</i>
Business development			X		
Industry competitiveness					
Industry reputation					

Short description of the 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 the debt contracting process 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 services¹, which are provided for in the Public Procurement Law. In addition to that, the exemption clause neither does not provide any definition for these services nor enumerates them.

This provision creates difficulties to the Ministry of Finance when contracting very complex debt because advisory, technical and other supporting services associated to the debt borrowing contracting process lack coverage in the law. This cause delays and additional costs and it hampers banks, investors, law firms and consulting companies to offer their services related to debt borrowing to the Ministry of Finance.

Stakeholder proposing the project: Ministry of Finance (MoF)

Other Stakeholders involved (sponsors): Public Procurement Agency(PPA), Banks, Consulting Companies, Law Firms

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

Project objective:

To improve Government debt contracting process by reviewing the relevant regulatory framework in order to cover the acquisition of advisory, technical and other supportive services.

Description of the project contribution toward financial modernization: By regulating environment for procuring advisory, technical and other supporting services, the access to debt borrowing improves and investments increase, facilitating economic development. For the financial and consulting industry, a regulated environment for advisory, technical and other supporting services related to debt borrowing means business development. For consumers as taxpayers for debt repayment, regulated debt borrowing services means transparency and better use of their taxes.

Project Working Group:

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The EU Better Regulation Approach	
Steps	Purpose
Scoping of problem	
1. Problem identification	To understand if a market/regulatory failure creates the case for regulatory intervention.
2. Definition of policy objectives	To identify the effects of the market /regulatory failure to the regulatory objectives.
3. “Do nothing” option	To identify and state the status quo.
4. Alternative policy options	To identify and state alternative policies (among them the “market solution”).

**Section 1:
Scoping the problem**

1.1. Problem identification

Public procurement is the process of using public funds by certain public body, for the purpose of acquiring external resources, generally from commercial bidders. In order to regulate this process, as the part of public sector reform and in relation to future EU membership, Albania has adopted a modern public procurement Law no. 9643 dated 20.11.2006 in line with the Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts.

The public procurement law regulates all main aspects of government and public bodies purchasing activities and provides them with the tools to be able to achieve “value for money” when procuring goods, services and works. It defines the main methods of public procurement, and steps to be used when applying them.

In Albania, foreign and domestic borrowing is governed by the Law no. 9665 dated 18.12.2006 on “State borrowing, state debt and state guarantee loans in the Republic of Albania”. According to article 26 of this law, in cases when Ministry of Finance obtains loans from private banks for financing public investments projects, creditor’s selection is made through public procurement procedures.

Recently foreign borrowing has gained momentum due to the access the country has to borrowing on the international financial markets, based on an improvement in 2007 of the country rating by Moody’s. It is also the Government strategy to reduce domestic borrowing and increase foreign borrowing for financing investment projects and fiscal deficit, 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/NSSSED/ 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 loan² from domestic and foreign banks under commercial terms. In 2009 the government contracted another 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 Eurobonds³ in international capital markets are complex processes, include many more stakeholders than the previous loans contracted from international organizations.

When contracting complex debt, Ministry of Finance would need advisory, technical and other supporting services (eg. legal services) in order to better assess costs, risks and to increase its negotiating capabilities.

Article 7 of the Law no. 9643 dated 20.11.2006 on Public Procurement excludes from the jurisdiction of the law financial services related to purchase, sale or title transfer or other financial instruments. The exemption clause neither does provide any definition for these services nor enumerates them. Also they are not provided for in any other legislation in Albania. The SPI Albania Secretariat has identified some 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, but the list could be longer⁴.

In general, 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. Sophistication of financial instruments will grow hand in hand with the sophistication and diversity of their associated services. Consequently, it may be difficult to determine accurately and conclusively all services associated to debt borrowing.

However, 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.

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;

² 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.

³ 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

⁴ For a deeper understanding of said services, please refer to the attached annex.

- Increase in the transaction cost risk due to limited analytics capabilities.

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

In this context, there is a need first, to identify and get a clear understanding on the advisory, technical and other supporting services associated to debt borrowing contracting process and second, revise/amend the relevant legal framework to include clear provisions on such services.

By regulating environment for procuring advisory, technical and other supporting services, the access to debt borrowing improves, thus facilitating Government financing needs. Also, including clear provisions on advisory, technical and other supporting services reduces the transaction costs for the Government and increases transparency. On macro level, the investments could increase and therefore economic development would be stimulated.

1.1.2 Market Analysis

General market: Financial market

Specific segment: Debt borrowing

1.1.3 Legal framework

Law No.9643 dated 20.11.2006, article 7 on Public Procurement

Law no. 9665 dated 18.12.2006, article 26 on “State borrowing, state debt and state guarantee loans in the Republic of Albania”

International benchmark: Directive 2004/18/EC of the European Parliament and of the Council of March 31,2004 on the coordination of procedures for the award of public works, contracts, public supply contracts and public service contracts.

1.1.4 Stakeholders - Institutional framework

- **Ministry of Finance:** The Ministry of Finance is the most important Government institution whose role is to mobilize and use effectively and efficiently public financial resources in order to reach goals and objectives set out in the Government program. According to the Law no. 9665 dated 18.12.2006 “On State borrowing, state debt and state guarantee loans in the Republic of Albania”, the Minister of Finance has the exclusive authority to manage government borrowing to meet essential financial needs (eg. finance budget deficit etc) of the government with the lowest cost.
- **Public Procurement Agency:** PPA is the central and highest body entrusted with the supervision and coordination of the public procurement system in Albania. PPA’s main objectives are enforcing current public procurement legislation and bringing it to EU standards, providing transparency and rigorous implementation of tendering procedures etc.
- **Commercial banks.** The Albanian banking system consists of 16 commercial banks having as main area of activity lending to individuals, companies and Government.

Consulting companies/Legal firms

1.2. Market/regulatory failure analysis (nature and evidence)

As a principle, the public procurement law regulates all main aspects of government and public bodies purchasing activities and provides them with the tools to be able to achieve “value for money” when procuring goods, services and works. The current regulatory framework excludes from the jurisdiction of the law financial services related to purchase, sale of title transfer. Such provision makes it difficult for the Ministry of Finance to acquire advisory, technical and other supporting services that are associated to the process of debt contracting. In addition to that the exemption clause neither does provide any definition for these services nor enumerates them.

This regulatory failure might determine delays, higher risks and costs in contracting debt.. There is no evidence of the occurrence of these effects, but the potential difficulties and risks are recognized by the authorities. The Albanian 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.

1.3. Policy Goal(s) threatened by the failure [e.g. financial stability, market integrity, market confidence, consumer protection, facilitating innovation, enhancing competition]

General Objectives:

- To enhance economic development

Specific objectives:

- To facilitate access to the debt markets
- To increase transparency in using public funds

Operational:

- To improve Government debt contracting process regarding the acquisition of advisory, technical and other supporting services.

1.4. “Do nothing” option

1.4.1 Possible medium-term (max 2 years) self – corrective market actions (e.g. mechanisms through which the “Do Nothing” option would address the market/regulatory failure).

The non-revision of the public procurement law with regard to acquisition of advisory, technical and other supporting services could cause delays for the Ministry of Finance in contracting debt, as the analysis is to be handled with internal limited resources. This has impact on liquidity and costs. Such situation would involve increase in the transaction

cost risk and would threaten Government’s transparency in using public funds.

1.4.2. Impact of the “Do Nothing” option to the various stakeholders

Impact on authorities:

- exposure to liquidity and transaction cost risk
- lower economic development
- lower transparency on the usage of public fund

Impact on banks:

- missed opportunities for business

Impact on consulting companies:

Lower business

1.5. Alternative policy option(s)

1.5.1. Description of Option 1:

To amend the current Public Procurement Law to include clear provisions on advisory, technical and other supporting services related to debt borrowing and treat the acquisition of such services as public procurement.

1.5.2. Description of Option 2

To amend the current foreign and domestic borrowing law to include clear provisions on advisory, technical and other supporting services related to debt borrowing.

1.5.3. Description of Option 3

To issue another legal act that would regulate the issue of advisory, technical and other supporting services associated to debt borrowing.

Summary Problem Scoping			
Revising the Debt Contracting Regulatory Framework			
Market failure			
Asymmetric information	Market power	Positive externalities	Negative externalities
(Existing) Regulatory failure			
Regulation wrongly prescribed for the market	Regulations succeeded in addressing the failure; a different market failure (e.g.	Regulation made it worse	Regulation so far has failed to work; maybe in due course

	side effect)		
X			

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 services⁵ 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/NSSSED/ 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 loan⁶ from domestic and foreign banks under commercial terms. In 2009 the government contracted another 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 Eurobonds⁷ in international capital markets are complex processes, include many more stakeholders

⁵ In the ToRs prepared for this project, other supporting services include but are not limited to legal services.

⁶ 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.

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:

A. Services prior to debt contracting

⁷ 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.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 credit⁸ 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 literature⁹ 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 1993¹⁰. 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

⁸ Wikipedia: A standard commercial letter of credit is a document issued mostly by a financial institution which provides an irrevocable payment undertaking

⁹ Choudhry, Moorad, The bond and money market, <http://books.google.com/books?id=Ih733yvfncC&pg=PA377&lpg=PA378&ots=-ACNotYtkU&dq=issuing+eurobond>

¹⁰ The US Securities Act of 1993

effective. In most cases 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 investor¹¹.

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 obligations¹².

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

¹¹ Choudhry, Moorad, The ibidem

¹² http://www.setimes.com/cocoon/setimes/xhtml/en_GB/features/setimes/features/2007/08/16/feature-02

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. The SAA agreement does not set any particular definition of advisory, technical and other supporting services related to debt contracting (please refer to appendix). 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 appendix). 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 the debt borrowing process 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.

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.**