NON-PERFORMING LOANS

1.67

WHITE BOOK BALANCE SCORE CARD

Recommendations:	Introduced in the WB:	Significant progress	Certain progress	No progress
Promoting out-of-court corporate debt restructuring in practice in accordance with the legislative framework and motivating investors to provide fresh money with super-seniority ranking over existing creditors under out-of-court voluntary debt restructuring.	2016			√
Enabling the assignment of NPLs between a Serbian bank and a Serbian borrower to non-residents regardless of whether they are in a syndicated loan or not.	2017			√
Eliminating the impediments to loan write-offs by banks.	2016	√		

CURRENT SITUATION

The share of non-performing loans (hereinafter: NPLs) in overall credits of the banking sector has been posting a constant decreasing trend, remaining within single digits. According to the latest figures, the share of NPLs is currently below 7%.

The Strategy for resolving NPLs (hereinafter: Strategy) adopted by the Government of the Republic of Serbia in August 2015 in order to define a solution for NPLs includes two action plans for its implementation: the Government Action Plan (of line ministries and other state institutions) and the Action Plan adopted by the National Bank of Serbia (hereinafter: NBS).

Among other things, the NBS Action Plan envisages the preparation of new and amendments to exiting legislation and supporting documentation related to: bank supervision, accounting standards and practices, the disclosure of data and information by banks, the valuation of collaterals, as well as a timeline for its completion (2015-2016).

In that sense, the NBS has enacted amendments to: the Decision on Reporting by Banks, Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items; Decision on Risk Management by Banks; Decision on Capital Adequacy of banks, Decision on Liquidity Risk Management by Banks, etc., thereby acting as a regulator and helping increase awareness and responsibility in banks' actions.

However, the real effect on banks' financial statements burdened by NPLs was achieved only after the enactment of the NBS Decision on the Accounting Write-Off of Bank Balance Sheet Assets, which has been in force since 30 September 2017. This Decision affected the enactment of amendments to tax regulations, which contributed to a positive resolution of the NPL issue at the end of 2017 and during 2018.

POSITIVE DEVELOPMENTS

The foregoing NBS Decision on the accounting write-off of bank balance sheet assets has enabled banks to proceed to accounting write-offs of NPLs by transferring balance sheet assets to off-balance items, when the calculated amount of impairment of a loan recorded by the bank in favour of allowances for impairment equals 100% of its gross book value.

Following this transfer of NPLs to off-balance, banks were given the opportunity to "clean" their financial balance. At the time of the actual write-off of NPLs from off-balance, the banks had no tax obligations that had existed under earlier legislation, which contributed to a considerable unburdening of banks. From the aspect of risk, this Decision allowed banks to proceed to the reduction of provisions if the NPL portfolio is lower than 10%. Since the beginning of this year, obligations related to allocating provisions have been fully abolished, despite the fact that the Decision on the classification of bank balance sheet assets and off-balance sheet items still provides the categorization of receivables (including NPLs), but this does not affect banks' liabilities regarding provisioning, i.e. the burdening of capital.

At the end of December 2018, the Government adopted the Programme of Resolution of Non-Performing Loans for the 2018-2020 period (hereinafter: Programme) with a related Action Plan for its implementation, which specified all activities implemented until then aimed at implementing the Strategy and which specified the adopted/amended regulations such as: the Corporate Profit

Tax Law and the Personal Income Tax Law, the Law on Enforcement and Security Interest, the Mortgage Law, the Law on Bankruptcy, the Law on Civil Proceeding as well as adoption of the Authentic Interpretation of Article 48 of the Law on Enforcement and Security Interest by the National Parliament in December 2017, initiated by the Foreign Investors Council.

In addition to resolving NPLs of state financial creditors and improving the bankruptcy framework, the Programme envisages activities aimed at preventing the occurrence of NPLs, which represents an improvement whose actual effects will be visible upon the expiry of the Programme.

In view of the fact that the adoption of the Decision on the accounting write-off of bank balance sheet assets had been overdue by more than a year, and that it had missed the deadlines provided under the NBS Action Plan as per the previous Strategy, a timely and compliant fulfillment of tasks foreseen by the Programme by all participants should be ensured as a prerequisite for the success of the Programme.

REMAINING ISSUES

Although the legal framework for voluntary financial restructuring was established with the adoption of the Law on Voluntary Financial Restructuring in 2015, the mechanism that it envisages has not yet been put in practice. During the process of resolving NPLs, banks and borrowers shall conclude Standstill Agreements, but when there are joint proposals for restructuring, parties rarely conclude a framework Standstill Agreement that involves all participants in the process, as they mostly proceed to conclude bilateral agreements. This suggests that there is room for additional improvements in the sense of mobilizing competent institutions in the application of this Law, which would contribute to efficient voluntary restructuring.

The lack of new financing sources remains a major obstacle in implementing out-of-court restructuring plans, because providers of fresh money are currently protected only in the case of bankruptcy.

The next potential obstacle for resolving financial difficulties may also come from inability to assign performing corporate loans outside the banking sector, which may prevent an efficient resolution of large groups of debtors encountering financial difficulties in business under restructuring.

Despite the fact that that the Law on Enforcement and Security Interest has been in force since July 2016, the extended periods of enforcement remain problematic in the context of the collection of receivables in practice.

Furthermore, Article 85a of the Law on Tax Procedure and Tax Administration envisages that, in order to ensuring tax collection, the Tax Administration may issue a Decision to enforce measures for ensuring tax collection, namely: a ban on the disposal of financial assets, a ban on the disposal, sale and encumbering of movables, a ban on the disposal, sale and encumbering of real estate or title to immovable property registered in public books, as well as a ban on enforcement by third parties. A Decision on establishing prior measures of securing tax collection becomes effective upon delivery, and the prior measure of collection is valid until the issue of a decision on enforced collection from the taxpayer's financial assets and the entry into the register of blocked accounts kept by the competent organization, the entry of lien into the register of movables, and/or register of real estate, and/or until a full collection of the taxes. Appealing this decision does not postpone enforcement. Thus, receivables related to taxes are not only privileged in relation to receivables of other creditors, which thereby may prevent the latter from implementing enforcement over an extended period of time, but this is also in direct collision with the provisions of the Mortgage Law as a "lex specialis" which stipulate the priority right of the mortgagee to settle receivables from the value of real estate under mortgage if the mortgage is registered before the Decision of the Tax Administration.

Article 18 of the Law on Foreign Exchange Operations allows resident banks to buy or sell receivables from a non-resident to a non-resident creditor – a participant in a syndicated loan, but that receivables under NPLs regarding loan contracts concluded between a resident bank and a resident, may not be assigned to a non-resident. Also, a resident borrower is obliged to notify the NBS of the conclusion of a loan contract abroad, so as to ensure the transfer of financial assets to or from Serbia, as well as any change of foreign creditor, and this may create certain problems in practice, such as disrupting the assignment of cross border loans by borrowers.

In the Q&A section available on its website, the NBS published an interpretation related to provisions of the Law on Banks pertaining to exceptions to keeping banking secrets. The NBS clarified that the formulation "other persons who,

due to the nature of their work, may have access to data considered a banking secret" should be interpreted so as to include investors in NPLs, as well as their legal and financial advisers into the transaction. This NBS interpretation provides a positive impetus to the NPL market, but the issue of banking secret must be resolved either by an amendment to the Law on Banks or through an authentic interpretation by the National Assembly of the Republic of Serbia.

Regulating synthetic sale arrangements would be helpful, especially from the aspect of tax legislation.

Finally, strengthening the institutional framework for speeding up procedures before the registers of pledges and the real estate cadastre is important for shortening the time needed to re-register mortgages and pledges under the name of new creditors.

FIC RECOMMENDATIONS

- Promoting out-of-court corporate debt restructuring in practice in accordance with the legislative framework and motivating investors to provide fresh money with super-seniority ranking over existing creditors under out-of-court voluntary debt restructuring.
- Enabling the assignment of NPLs between a Serbian bank and a Serbian borrower to non-residents, regardless of whether they are in a syndicated loan or not.
- Eliminating the impediments for the assignment of performing receivables of legal entities from banks to other legal entities, and not just to banks.