FOREIGN EXCHANGE OPERATIONS

1.14

WHITE BOOK BALANCE SCORE CARD

Recommendations:	Introduced in the WB:	Significant progress	Certain progress	No progress
Adapt the wording of the Law and interpretation in practice so that prohibited operations are explicitly prescribed as such, whereas all other activities are considered permitted.	2017			√
Ensure a better public availability of opinions of state authorities in charge of forex operations, in particular the NBS, for the consistency in application of regulations by all participants (e.g., to introduce the publication of official opinions on the regulator's website, introduce a section with responses to questions on the website, etc.).	2016			√
Reconsider the wide scope of NBS' discretion to restrict a resident from granting securities or guarantees in relation to foreign loans, especially in relation to regular foreign loans and further regulate the procedure thereof.	2017			√
Simplify the set-off rules for all types of current and capital transactions and allow cash pooling between affiliated parties.	2012			√
Reconsider Articles 7, 20 and 33 of the Law so that the transfer, payment and collection of receivables and debts are resolved adequately for all types of current and capital transactions.	2013			√
Enable foreign inflows without prior notification to the bank, subject to condition (if necessary) for such notification to be made subsequently and electronically at certain time intervals (e.g. monthly, quarterly, etc.).	2018		√	
Further liberalization of foreign deposit transactions of residents, especially for companies subject to project financing by foreign banks and international financial institutions.	2018			√

CURRENT SITUATION

Since 28 April 2018, when amendments to the Law on Foreign Exchange Operations (Official Gazette of RS nos. 62/2006, 31/2011, 119/2012, 139/2014 and 30/2018) (hereinafter: "Law") entered into force, no significant changes in the field of foreign exchange regulations have occurred. However, the adoption of last year's amendments of the Law brought Serbia closer to the fulfilment of its obligations under the Stabilisation and Association Agreement (SAA) in the area of movement of capital towards member states of the European Union (EU) and alignment with international standards in the prevention of money laundering and terrorism financing. Additionally, these amendments tend to contribute to the further development of the digital and IT sector in Serbia - in accordance with the Serbian Government's activities aimed at improving this area.

Since the last edition of the White Book, only several by-laws have been adopted and amended. The most significant change relates to the takeover of foreign exchange supervision by the National Bank of Serbia (NBS) from the Ministry of Finance – Tax Administration over the issuance and withdrawal of authorizations and certificates for performing currency exchange operations and the supervision over currency exchange operations and foreign exchange operations of residents and non-residents. To fully implement this taking over of the supervision, the NBS rendered a Decision on Detailed Conditions and Manner of Conducting Supervision of Foreign Exchange Operations, which prescribes the conditions of two forms of supervision powers granted to the NBS – indirect and direct – and a relatively broad scope of actions which can be undertaken by the NBS.

Certain other changes to the NBS by-laws have been made during the year, such as in the field of financial derivatives operations and the foreign exchange market, however, none of them are of particular significance.

Certain recommendations from previous White Book editions have been adopted, with their results observed in practice during the last year, such as enabling (under cer-

tain conditions) residents - legal entities to provide guarantees and other types of security for credit operations of parent companies abroad, introducing the creditor's consent for the transfer of debt arising from realized foreign trade in goods and services; enabling residents to obtain guarantees from non-residents for the performance of investment works of non-residents in Serbia; and liberalizing rules concerning the possibility for residents - natural persons to trade in securities abroad.

In conclusion, although improvements in the field of foreign exchange operations are becoming more and more visible in practice, there is still room for further liberalization of the Law in order to increase the attractiveness of investing in Serbia.

POSITIVE DEVELOPMENTS

Apart from the adoption and amendments to the aforesaid by-laws, unlike the previous year, during the past year there have been no material changes to the Law and/or the by-laws, and thus significant steps forward in this area have not been made.

REMAINING ISSUES

Despite the partial liberalization in the field of forex operations, the current legislation remains restrictive, with the aim of protecting and preserving the macroeconomic stability.

We believe it is necessary to adapt the wording of the Law and the interpretation in practice to the approach in which prohibited operations are explicitly prescribed as such, while all other activities should be considered permitted. This principle has already been set out in Articles 3 (1) and 10 (1) of the Law, however, due to the legislative approach prescribing, in other parts of the Law, which transactions residents and non-residents may perform, the predominant interpretation in practice remains that all other unregulated activities are not in accordance with the Law. Legal transactions and the market continuously evolve, and it is neither possible nor expedient to apply a legislative technique that lists allowed operations, while regarding the others as unpermitted. In practice, this perennial approach results in situations where certain operations, which the legislator does not seem to intend to exclude, cannot be performed due to the lack of governing norms. In addition, it is noticeable that, in certain matters, the competent authorities' interpretation narrows down the scope of application of certain rules, thereby constraining the operations of participants in the field of forex operations.

However, if a list of permitted transactions is retained, we believe that it needs to be expanded wherever justified and feasible, especially when it comes to groups of affiliates, which seek to simplify financial relations within the group. Therefore, the issue of the liberalization of foreign credit and deposit operations remains open, and such liberalization is necessary to enable the provision of more sophisticated banking services, such as cash management, cash pooling and similar packages.

We emphasize that the issues of the transfer, payment and collection of receivables based on current and capital transactions are not adequately regulated, since only Article 33 sets the rule for all types of permitted current and capital operations, but only in transfers between two non-residents. Articles 7 and 20 regulate transfers in 'realized' foreign trade and credit transactions, while similar rules are missing for all other types of transactions - for example, for receivables arising out of direct investment, guarantees, real estate, etc. The very concept of realized foreign trade is not clear, and brings into question the possibility of transfer under Article 7 when it comes to claiming an advance payment refund before the performance of the transaction. Also, the provisions on obtaining the approval of the Government for certain operations, in particular Articles 7, 20 and 33, need to be re-examined as they appear to be unnecessarily broad and restrictive, especially when it comes to the assignment of non-resident's receivables. In addition, the term "state-owned company" used in these articles is not clear and should be specified so as not to include companies with minority state capital (in which cases it appears inappropriate to be required to obtain approval from the Government).

Moreover, in relation to Article 6 of the Law and the relevant by-laws, it remains necessary to liberalize the cross-border set-off of mutual receivables and debts, in accordance with the general rules of contract law. The current set-off rules are defined only for certain types of operations, while there remains a gap when it comes to other operations (e.g. real estate operations) and the interpretation in practice that these are unpermitted. Also, there is a need in practice to liberalize foreign deposit operations of residents, especially for companies that are the subject of project financing by foreign banks and international financial institutions.

Furthermore, the by-laws regarding foreign cash inflows do not fully allow the automation of international payment transactions. In order to realize a foreign cash inflow, a resident must first provide the bank with information regarding the basis for collection and other data necessary for the execution of the collection. In its attempt at liberalization, the NBS excluded the application of the aforementioned procedure for certain types of inflows on a single basis in the amount of up to EUR 1,000, but only within the IT sector. Given the modern business dynamics, it is necessary to also abolish these administrative requirements for non-IT businesses, as well as for inflows with different legal bases and exceeding EUR 1,000.

By amendments to the Article 23 of the Law and the adoption of the relevant by-law in 2018, the Law envisaged possibilities of granting financial loans by a resident – legal entity to non-residents, as well as providing guarantees and collaterals by a resident – legal entity for obligations of non-resident under a credit transaction between two non-residents, for certain categories of non-residents (if they are from EU member states or a non-resident debtor is majority owned by a resident). These amendments led to certain ambiguity as to intentions of the legislator. It is not clear why the intention of the legislator was limited only to the granting of guarantees and collaterals by residents only for credit transactions between non-residents, and not for guarantee transactions in terms of Article 26 of the Law, in relation to which a further liberalization of the Law is still required.

Additionally, in practice the manner of granting collaterals pursuant to Article 23 of the Law is performed in the way that granting a loan to a non-resident by a resident bank or the issuance of a guarantee to a non-resident bank, upon instruction of the non-resident (under a credit transaction between two non-residents), resident banks are obliged to obtain collaterals from a non-resident borrower or non-resident client, which are often of lower quality compared to collaterals which resident banks could obtain from a resident/owner of a specific non-resident, which has an undoubtable legal interest to provide collaterals for a transaction of its subsidiary.

Therefore the next amendments to the Law should include a liberalization of this article in terms of enabling resident banks to obtain collaterals from resident/owner of non-resident under guarantee transactions between two non-residents.

Also, a resident bank finances a non-resident abroad for which it is obliged to obtain adequate collateral under the Law. In accordance with the Decision on conditions and manner under which a resident may grant financial loans to non-residents and grant guarantees and other collaterals under cross-border credit transactions and credit transactions between non-residents, a resident/owner of non-resident in this case is not entitled to provide any collateral, given that the Law enables collateralization by a resident only in credit transactions between two non-residents, but not in the case of crediting a non-resident by a resident bank. In this way resident banks are put into a disadvantaged position against non-resident banks financing a non-resident.

Moreover, with amendments to Article 23 and the adoption of a new by-law of the NBS, only the conditions for granting financial loans to non-residents - debtors from EU member states have been liberalized. However, the restriction on residents to approve a financial loan to a non-resident only if it is majority owned by a resident is still applicable to non-residents outside of the EU member states. It is unclear how this change will affect entities such as international financial organizations, whose formal registered seat is neither in the EU nor outside the EU. Additionally, the newly-introduced discretion of the NBS to restrict individual residents from providing guarantees and other types of security for foreign loans or from granting loans to non-residents creates significant legal uncertainty. The restriction procedure itself and the moment at which the NBS may render the decision on restriction have not been further defined. Furthermore, the wide scope of this discretion of the NBS' applies not only to foreign loans granted by a resident to a non-resident and guarantees/securities for foreign loans, but also to guarantees/securities provided by residents for foreign loans taken by residents (which tightens the legal regime for such loans).

Finally, with amendments to Article 32, the Law now allows legal entities and entrepreneurs to perform cross-border payment transactions through a payment institution and the public postal operator. At the same time, however, the Law on Payment Transactions of Legal Entities, Entrepreneurs and Individuals Not Engaged in Business Activity ("RS Official Gazette" No. 68/2015) prescribes the obligation for legal entities and entrepreneurs to make payments through a current account opened with a bank or the Treasury Department (which indirectly indicates that payment institutions and the public postal

operator are not authorized to conduct international payment operations). For this reason, it is necessary to harmonize the aforementioned law and the law regulating payment services with the amendments to the Law in order to fully enable legal entities and entrepreneurs to perform cross-border payment transactions through a payment institution and the public postal operator.

Also, we would suggest defining names and rules for two types of contract known in international practice as the Funded / Unfunded Risk Participation Agreement (hereinafter FRPA/ URPA). In the case of FRPA, a resident bank, as a form of collateral, makes a deposit into the account of a non-resident creditor before receivables are due in the amount of the claim that the non-resident creditor has against a debtor-resident. When it comes to URPA, a resident bank guarantees making a deposit into the account of a non-resident creditor in the case that a debtor-resident fails to pay on the maturity of the claim.

In both cases, the mentioned deposits are a form of guarantee on the basis of which the non-resident creditor will be reimbursed in the event that the debtor - resident fails to fulfill his due obligation. In an FRPA arrangement, the non-resident creditor undertakes the obligation to repay given funds to the resident bank when it is collected from the resident debtor, and the same obligation exists in an URP arrangement, when the non-resident creditor subsequently collects its claims from the resident debtor. In order to enable a proper contracting of these types of Risk Participation Agreement, it would be necessary to define and regulate them by the Law.

Therefore, the policy in the area of forex operations should be directed towards the further liberalization of current and capital transactions in order to harmonize the applicable Serbian legislation with EU regulations and international standards in this area. It should also be ensured that the application and interpretation of the regulations by the competent authorities is accompanied by adequate amendments.

FIC RECOMMENDATIONS

- Adapt the wording of the Law and interpretation in practice so that prohibited operations are explicitly prescribed as such, whereas all other activities are considered permitted.
- Ensure a better public availability of opinions of state authorities in charge of forex operations, in particular the NBS, for the consistency in application of regulations by all participants (e.g., to introduce the publication of official opinions on the regulator's website, introduce a section with responses to questions on the website, etc.).
- Reconsider the wide scope of the NBS' discretion to restrict a resident from granting securities or guarantees in relation to foreign loans, especially in relation to regular foreign loans and further regulate the procedure thereof, as envisaged by the by-law of the NBS which was adopted last year in parallel with amendments to the Law under the amended Article 23.
- Simplify the set-off rules from Article 6 of the Law (and relevant by-laws) for all types of current and capital transactions and allow cash pooling between affiliated entities.
- Reconsider Articles 7, 20 and 33 of the Law so that the transfer, payment and collection of receivables and debts are resolved adequately for all types of current and capital transactions.
- Enable foreign inflows without prior notification to the bank, as currently envisaged by by-laws governing cross-border cash inflow and outflow, subject to the condition (if necessary) for such notification to be made subsequently and electronically at certain time intervals (e.g. monthly, quarterly, etc.).
- Further liberalization of foreign deposit transactions of residents, especially for companies subject to project financing by foreign banks and international financial institutions.