

CAPITAL MARKET TRENDS

1.60

WHITE BOOK BALANCE SCORE CARD

Recommendations:	Introduced in the WB:	Significant progress	Certain progress	No progress
The issuance of state and municipal bonds for the financing of infrastructural and other large communal projects, including green bonds, should be stimulated, while IPOs and issuance of corporate bonds in the private sector should be encouraged.	2015		√	
The legal framework for performing operations with financial derivatives and more complex financial instruments should be improved, including in relation to establishment of regulatory framework in connection with Employee Share Plans, and crowd financing and its manifestations.	2015			√
It is necessary to amend the Law on Financial Collateral in order to make available to commercial entities protection in derivatives transactions in the way that is provided to other entities to which its provisions apply.	2021			√
Further stimulation of the possibility of Serbian residents to invest in more complex securities on foreign markets, including structural products, structural deposits, ETFs and investment funds, all in accordance with European standards and ESMA guidelines.	2017			√

CURRENT SITUATION

The existing regulatory framework is partly harmonized with European Union legislation and IOSCO principles, but the Serbian capital market is still underdeveloped and the regulatory framework has yet to be tested in practice, so all the potential flaws of the reforms implemented back in 2011, and of the additional more material reforms from 2016 and 2018, cannot be duly assessed.

Although noticeable, regulatory reforms alone were not enough to stimulate growth of the capital market. There is a constant downward trend in the number of financial instrument issuers as well as of public joint stock companies where such trend was also continued in the previous year, according to the publicly available information of the Central Securities Depository and Clearing House.

Despite the emergence of interesting new products on the debt instruments market, we need to note once again that the capital market in Serbia is still developing and that there are still issues associated with quality and liquidity of capital market products.

POSITIVE DEVELOPMENTS

Last year recommendations in relation to which certain developments were made:

- The issuance of state and municipal bonds for the financing of infrastructural and other large communal projects should be stimulated, while IPOs and issuance of corporate bonds in the private sector should be encouraged.

Enactment of the Regulation on the Procedure for Issuance of Debt Securities by which procedure for issuing corporate bonds, as an additional financing option, was eased for the limited period of time, although in relation to COVID – 19 pandemic and its effects on the economy, could also generally have positive effects on stimulation of the issue of corporate bonds as way of financing in future.

The indication of potentially positive movements on the corporate bonds market in Serbia in future could be trading with corporate bonds of the state-owned Telekom Srbija and a number of other state-owned companies, which were offered to local banks and also partially purchased by the National Bank of Serbia.

Also, in relation to education and support of initial public offerings, we commend activities on the "IPO Go!" programme – a project of the Belgrade Stock Exchange supported by, inter alia, EBRD (through EBRD SSF), which was launched in 2018.

Although this is not new, significant event was the issuing of RSD 2.5 billion worth of dinar bonds by EBRD in Decem-

ber 2016, which boosted investors' confidence in Serbia's capital market.

- The legal framework for performing operations with financial derivatives and more complex financial instruments should be improved, in which regard we believe that the amendments to the Law on Financial Security to also apply it to business subjects, in addition to financial institutions, would represent a major step towards regulating legislation on transactions with financial derivatives.
- Furthermore, improving the legal framework in connection with Employee Share Plans and crowd financing and its manifestations is also necessary.

As the most important novelty and development in this segment, we emphasise enactment of the Regulation on Financial Derivatives Transactions for the Purpose of Managing the Republic of Serbia's Public Debt, which lays down the general conditions for the performance of financial derivatives transactions by the Serbia for the purpose of hedging. Although this Regulation was enacted in 2019 it came into force in the begging of 2020, where implementation practices are already being established to a certain extent. According to the publicly available information published by the Serbian Administration for Public Debt, a couple of financial derivatives transactions were entered into by Serbia in 2020, for certain hedging purposes.

It is important, in parallel with improving the legal framework, to continue jointly with the NBS the education campaign of corporate participants on the benefits of introducing financial derivatives in business and to provide support (accounting, IT, technical etc.) in order to foster demand for these instruments. Special focus should be put on promoting the interest swap (IRS) as financial derivative, which protects legal entities from the now imminent risk of interest rates increase.

Additional developments:

We point out to the enactment of the Law on Digital Assets, which for the first time provides legal grounds for, inter alia, issuance of digital assets (including virtual currencies) on the primary market as well as secondary trading therewith. Although the said Law and the relevant bylaws are yet to be tested in practice, we commend regulation of this area and efforts of, inter alia, the Securities Commission in relation thereto.

Moreover, we welcome the announcement of the National Strategy for the Development of the Capital Market, which may have an important impact on growth of the capital market in Serbia.

REMAINING ISSUES

We have to note that identifying all of the remaining legislative issues related to the capital market is difficult as the capital market in Serbia is rather underdeveloped, i.e. shallow and insufficiently liquid.

Although state bonds are being successfully issued in the practice, municipal bonds are still rare, and these bonds were not traded on the secondary market. The same applies for the corporate bonds market, which is still in development. Certain types of bonds are still not present on the market, such as government bonds that are linked to the inflation rate and government bonds whose coupon rate is linked to a variable interest rate (BELIBOR, EURIBOR). The potential introduction of the mentioned types of government bonds would enable banks and other investors to better manage market risks (risk of interest rate changes or revaluation of asset values due to the inflation rate) in their balance sheets.

Consider the possibility of taking some more concrete steps in the construction of the dinar yield curve in cooperation with regulatory institutions, since the volume and liquidity of transactions among market participants on the secondary market does not allow obtaining reliable values for this curve. An example could be the organization of several primary auctions of the Public Debt Administration for the sale of government bonds with several different maturities compared to the existing ones. Another example could be auctions with several possible maturities of NBS repo operations (in addition to the existing weekly auctions with maturities of 7 days).

Regulatory should be improved to enable transactions with more complex financial instruments, including the regulatory framework by which more liberal approach and better legal certainty in relation to Employee Share Plans, as well as regulatory framework in relation to securitization.

The Law on Financial Collaterals, which application began in January 2019, was adopted in order to regulate the security procedure in transactions with financial derivatives. Although the draft provided that the Law applies to both financial institutions and legal entities, in the process of adoption the relevant provisions relating to commercial

entities were excluded, thereby not giving the opportunity for them to be on an equal footing with other participants in the subject transactions; to utilize the benefits and perform netting of claims in accordance with the provisions of this Law; to use the protection provided by the financial collateral agreement, as well as the protection in case of bankruptcy proceedings of the other party. Therefore, we believe that it is necessary to amend this Law in order to provide legal entities with the stated level of protection.

Therefore we believe that the engagement of the Ministry of Economy first of all, as well as other relevant authorities, is needed in order to amend this Law in order to provide legal entities with the mentioned level of protection.

We note that it is necessary to establish a straightforward regulatory regime so to support more complex investment methods through crowd funding, as potential way of financing of small and micro enterprises.

FIC RECOMMENDATIONS

- The issuance of state and municipal bonds for the financing of infrastructural and other large communal projects, including green corporate bonds, should be stimulated, while IPOs and issuance of corporate bonds in the private sector should be encouraged. Consider the possibility that the state starts issuing bonds whose coupon is linked to the inflation rate and with a variable coupon rate.
- Consider with the regulatory authorities the possibility of organizing more frequent primary auctions of government bonds with different maturities compared to the existing ones and/or increasing the number of NBS repo auctions with different maturities
- The legal framework for performing operations with financial derivatives and more complex financial instruments should be improved, including in relation to establishment of regulatory framework in connection with Employee Share Plans, and crowd financing and its manifestations.
- It is necessary to amend the Law on Financial Collateral in order to make available to commercial entities protection in derivatives transactions in the way that is provided to other entities to which its provisions apply.
- Further stimulation of the possibility of Serbian residents to invest in more complex securities on foreign markets, including structural products, structural deposits, ETFs and investment funds, all in accordance with European standards and ESMA guidelines.