

CAPITAL MARKET TRENDS

2.00

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 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.	2015	√		
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	2023		√	
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 (Law on Capital Market) is almost completely harmonized with European Union legislation, but domestic 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 2015, 2016 and 2020 and 2021, cannot be duly assessed.

Although noticeable, regulatory reforms alone were not enough to stimulate growth of the capital market. A downward trend in the number of financial instrument issuers and public joint stock companies listed on the Belgrade stock-exchange is still present. On the other hand, government bond issuance for financing eco-preservation, infrastructure and developmental projects are on the notable rise in 2023 and in 2024.

In 2023 government initiated a capital market reform project with donation of the International bank for reconstruction and development aimed at fostering long-term financing via corporate bond issuance (Catalysing Long Term Finance trough Capital Markets Project). Project's goal is to develop legal, regulatory and economic environ-

ment, as well as to broaden and deepen corporate bonds market, including Green bonds and other special type of debt instruments. Besides, project would strive to increase demand and attract more bond investors through simplification of the capital market tax regime.

More corporate clients should be motivated to get access to capital via bond issuance, with a portion of these bonds traded on the Belgrade stock exchange. We need to note once again that the capital market in Serbia is still developing and that there are still issues associated with low quality and liquidity of capital market products.

POSITIVE DEVELOPMENTS

Last year recommendations in relation to which tangible developments were noted:

- 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.

Public Debt Agency held several primary market auctions during Q4 2023 and Q1 2024 and successfully sold around 150

bln worth of dinar bonds with initial maturity of 8 years and significant participation of foreign portfolio investors. New benchmark bond is included in JP Morgan government bond index. Fund collected via bond issuance will mostly be used for financing rail and road infrastructure, as well as for EXPO 2027 project. Bond issuance significantly contributed towards increase in the local currency participation in the public debt and achieved final issuance yield is quite favourable.

During 2024, government continued with initiative of broader Serbia inclusion in the global Green agenda and issued an ESG bond worth \$1,5bln. Fund collected via bond issuance will be used for energy efficiency projects, transition towards sustainable and renewable energy sources, further inclusion of minority groups (social, ethnic etc.), assistance to citizens purchasing first flats, populating the rural areas as well as other ESG compliant projects.

As already explained, with support of World Bank donation worth \$20mln, government in 2023 embarked on project to facilitate process of corporate bonds issuance. Focus of the project is to provide expertise for potential corporate issuers regarding the issuance process, as well as reduction of fees for compiling prospectus and regulatory approvals. Current phase of the project entails election of the qualified agents and consultants, while first bonds should be offered to public in Q3 2024.

- 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. We believe that the aforementioned would represent a significant step forward in the direction of further regulation of legislation related to enabling greater legal certainty in 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. Good example of commendable hedging practice is continued state effort to protect against foreign exchange risk portion of the public debt in USD, via arranging the conversion of the ESG bond dollar proceeds in EUR.

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 risk of changing interest rates. Even though demand for hedging in the environment of rising Euribor rates was limited, it is of utmost importance to continue with efforts to foster active risk management culture.

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.

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. 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), as well as short-

term government bills. The potential introduction of the mentioned types of government bonds would enable banks and other investors to better manage their liquidity surpluses and 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

- To continue with the issuance of state and municipal bonds for the financing of infrastructural and other large communal projects, including green corporate bonds, 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, as well as short-term treasury bills.
- 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.