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Serbia: Draft of the Financial Securities Law

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The National Bank of Serbia recently prepared a draft of the Financial Securities Law (the „Draft“). The Draft is open for public discussion until November 20, 2016. It is expected that this piece of legislation will enter into force on 1 January 2017. The relevant EU regulations have been taken into account while preparing this legislation.

Once adopted, this law should represent a comprehensive and uniform framework for contracting of financial collateral, aimed to contribute to improving legal certainty and efficiency in carrying out the obligations of participants in the financial market. The Draft creates conditions for further improvement of the financial system and its infrastructure, especially in regards to legal security of both creditors and borrowers. One of the main goals is reducing credit and systemic risk and ensuring financial stability.

Among the most important proposals in the Draft is the introduction of the “agreement on financial security”, with its essential elements and modes of contracting, and with an explicit recognition of the possibilities for pledge or transfer of ownership on the means of financial security. The proposed solutions determine clear rules for contracting and utilization of various means of financial security, as well as for payment from those securities, which should help reduce the credit risk of financial market participants.

The Draft also provides simpler and more efficient procedures for the settlement of claims. Under prescribed conditions, there is a possibility of selling or appropriating financial securities for the purpose of claims settlement. Special attention is paid to the so-called close-out netting, as well as to the protection of a recipient of a financial security in the event of insolvency proceedings against the provider of the security. This is a long time expected change for the development of the financial derivatives market.

So far, close-out netting was not clearly regulated in Serbia. Provisions governing close-out netting were dispersed among several pieces of primary and secondary legislation, such as the Law on Bankruptcy, the Law on Bankruptcy and Liquidation of Banks and Insurance Companies, the Law on Contracts and Torts, the Decision on the Capital Adequacy of Banks, and the Decision on the Provision of Transactions with Financial Products. Such provisions did not offer sufficient measures for clear and successful implementation of close-out netting principles, which left many uncertainties for participants in the financial market, especially in regards to the insolvency proceedings.

The Draft emphasizes as an important novelty that the commencement of insolvency proceedings does not affect exercise and fulfilment of rights and duties from the agreement on financial securities, and therefore protects a recipient of a financial security in the event of insolvency proceedings against the provider of the security.

The Draft is aligned with the Law on Bankruptcy in terms of allowing for entering into the agreement on financial securities before issuing a decision on commencement of insolvency proceedings. However, the Draft diverges from the Law on Bankruptcy in case when the insolvency creditor knew or ought to have known that the debtor was insolvent or overindebted.

Still, there seem to remain some uncertainties regarding the elements of insolvency proceedings, such as “cherry-picking” (the right of an insolvency administrator to terminate loss-making agreements and require from the counterparty to perform profitable agreements). Furthermore, for the full implementation of these new institutes envisioned in the Draft, further alignment of other relevant legislation will be needed.

Nevertheless, overall novelties and changes that the Draft proposes are expected to contribute to the improvement of the financial market, and thus create more favorable business conditions for foreign investors and creditors if the Draft is adopted in the current form.