



## NON-PERFORMING LOANS

# Debt concerns in Serbia

With bad loans undermining a recovery in the banking system, the government must put forward radical solutions



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As is the case in surrounding jurisdictions, the banking sector in Serbia has reached a high level of non-performing loans (NPLs) – in fact, 22.6 per cent of the entire banking debt portfolio (approximately €3.6bn) is attributed to this category, according to official data from the National Bank of Serbia (NBS).

Besides the official data there are, of course, unofficial estimates by certain experts who claim that the share of the entire banking debt portfolio is as high as 40 to 50 per cent.

Whatever the exact percentage may be, the worrisome fact is that every third corporate loan is in default as retail debts comprise a relatively small portion of Serbia's NPLs. Further aggravating the issue is the fact that the legislative solution is nowhere in sight as yet, so it is realistic to expect that the situation will get worse before it gets better.

The issue of NPLs in Serbia is certainly gaining in importance as it undermines a sustained recovery of the Serbian banking system, creating more problems for the future which the state and the banks have so far been reluctant to deal with.

More precisely, the state has traditionally lacked the capacity to fully understand and anticipate the issues by putting in place adequate legislative provisions while the banks, operating in an inadequate legal environment with regard to NPLs, fear the consequences of writing off NPLs and strongly resist selling them at the currently low market prices.

Of course, the best solution would be to find a way for the debtors to repay most of their debts in order for the banks to recover a sufficient amount of receivables to reboot the loan market. However, significant obstacles exist with regard to this model too, since any write-off of bad debts triggers 20 per cent corporate income tax without the ability to refund the VAT.

### Screening

There may, however, be good news for those hoping that the issue of NPLs will finally be confronted by the state as the government of Serbia promised to the IMF it will offer a solution. The NBS is screening the banking sector in Serbia and plans to come up with measures to be implemented on a national level.

On the legal side of things, the consensus is that not only tax-related legislation must be amended and supplemented to make NPL portfolios either attractive to investors or efficiently enforceable. Court practice too needs to be unified and the legislation governing collection and enforcement needs additional amendment and supplementation. This includes the Law on Bankruptcy, Mortgage Law,

Law on Pledge of Movable, Enforcement Law and numerous other pieces of legislation.

The key is that the NBS and the relevant working group consider this topic in a serious manner so as to ensure efficient assignment, collection and recollection of bad debts while assisting with the restructuring or bankruptcy of insolvent debtors.

The present legislative framework includes the Decision on Risk Management of Banks issued by the NBS, which allows the assignment of corporate NPLs from banks to other legal persons. Prior to this decision the banks were able to assign NPLs only to other banks. There are additional requirements in place regarding such assignment, such as prior notification of the NBS (30 days as a general rule, five days in urgent cases) and the NBS maintains a strict monitoring regime. In practice, this means that private funds and other non-banking investors may now consider purchasing massive NPL portfolios from Serbian banks but to date, this has not taken place.

It may be, as some bankers claim, that the Serbian market is too small to be interesting to funds investing in NPLs, but it is just as likely that Serbian banks are not being realistic in terms of the discounts they are offering.

### Blocked bank accounts

When it comes to retail NPLs, under the Law on Protection of Consumers of Financial Services and other relevant legislation, they may be assigned only to other banks. While corporate debts remain by far the most significant part of the problem, there are more than 200,000 individuals in Serbia with blocked bank accounts due to defaulting on their loans. Hence, retail debts are highly likely to get on the government's agenda as well. This could be regulated through a Serbian version of Chapter 11 – in other words, a special law on personal bankruptcy. It has been announced that this will be enacted soon but there is no working draft in sight.

In conclusion, Serbia is quite a way behind most European countries, which have rightly treated the issue of NPLs as a priority and addressed it on a policy level. Therefore, whatever solution the government and the NBS come up with, it will likely be a radical one.



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