NON PERFORMING LOANS

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NPLs in Serbia
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NPLS IN SERBIA

Non-performing loans (NPL) are one of the principal problems of Serbian banking sector. Since 2009, number of domestic and international institutions have conducted various studies regarding NPL growth and have concluded that such growth is indicative of relevant macroeconomic factors. The main macroeconomic reasons for NPL growth in Serbia since 2008 have been increasing unemployment, currency depreciation and higher inflation rate.

On the other hand Serbian banking sector is highly capitalized and liquid. Even though the NPL are a growing issue, that still does not endanger the stability of the financial system given that these loans are covered by regulatory reserves.

The total amount of NPL in Serbia is approx. 3.5 billion EUR. Expressed in percentage terms, NPL represent 23% of total loans while the level of NPL turnover in Serbia can be characterized as insignificant.

In June 2015 the Serbian Government rendered its "NPL Resolution Strategy" (Strategy). Along with the Strategy it adopted an action plan, in order for the Strategy to be implemented. The main goal behind the Strategy was preventing NPL accumulation to the level that would negatively impact lending activity and adversely affect economic growth. In order to do so, the Government focused on one of the key priorities - conducting an overhaul of the regulatory framework with the aim of addressing issues associated with selling of problematic loans.

Improving conditions for NPL market development is another key priority contained in the Strategy.

To a large degree banks in Serbia are still relying on traditional mechanisms for securing their receivables (mortgages and pledges) which has proven unsufficient. The 'wait and see' approach has been highly prevalent among the banks. Once a debtor becomes insolvent, the banks activate a mortgage or a pledge (or some other established collateral), instead of selling a problematic receivable at a substantial discount.

In cases where banks activate a mortgage, the sale price is often proven to be much lower compared to earlier estimates, primarily due to overly optimistic (to the point of material inaccuracy) property valuations.

Generally speaking, there are many practical impediments with respect to achieving marked increase of investments in Serbia. It is worthwhile to mention significant obstacles such as ineffective bureaucracy, slow court proceedings and suboptimal functioning of other competent authorities and institutions. In particular relevant to the NPL problem in Serbia are issues associated with real estate cadasters and bankruptcy managers.

At the moment, pursuant to the Decision on Risk Management, a bank may assign its corporate NPL to another bank or to another legal entity, with the obligation to inform National Bank of Serbia (NBS) of such assignment no later than 30 days prior to executing the agreement giving effect to it.

The NBS introduced novelty pursuant to recently (July 2016) amended Decision on Risk Management allowing the banks to assign also not matured receivable, to another legal entity, that is considered as problematic pursuant to NBS Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items (also amended in July 2016 and applicable as of 1 October 2016).

With respect to the retail NPL, pursuant to applicable Law on Protection of Financial Services Users, retail NPL may be assigned only to another bank. Notably, there are additional legal impediments to the NPL market development in Serbia.

Namely, applicable Litigation Law does not provide for a possibility for NPL acquirer to takeover the place in an ongoing dispute, without prior explicit consent of the counterparty.

The applicable legal framework in Serbia does not provide for synthetic sales of NPLs which would be easier to perform due to less stringent formalities subsequent to the sale.

Furthermore, pursuant to the bank secrecy legal framework (broadly defined), banks may not transfer data to the NPLs acquirer, without prior grant of written consent by client in question.

Moreover, the applicable Foreign Exchange Operation Law does not allow for a loan entered into between a Serbian bank and a Serbian resident to be assigned to a non-resident entity.

Also, a resident borrower shall inform NBS on execution of a cross-border loan agreement in order for funds to be wired in or out of Serbia, as well as on every change of cross-border creditor which in itself may cause certain problems in practice such as obstruction of cross-border loan assignment by a borrower.

With respect to an overvalued initial appraisal of NPL collaterals, the applicable legal framework neither provides a clearly set out criteria governing the appraisal of such collaterals, nor it specifies certain requirements on licensing of private collateral appraisers. However, as of July 2016, pursuant to amended Decision on Risk Management, banks are obliged to internally define certain criteria regarding selection of licensed private collateral appraisers, as well as to introduce their duties and responsibilities, all in accordance with prescribed international standards. Banks shall establish and at least once a year update the list of eligible private collateral appraisers, based on the quality of their previous appraisals.

In case of an NPL transfer, re-registration of mortgagees in the name of a new creditor (acquirer of NPL) is extremely slow due to inefficiencies of real estate cadasters, which adversely affects NPL transfers. In addition, a debtor may obstruct the re-registration of such mortgage by submitting an appeal which could last for several years due to slow proceedings.

Moreover, applicable Bankruptcy Law does not guarantee super seniority over existing creditors with respect to fresh money injection into a distressed company which is a subject of reorganisation proceeding.

The Bankruptcy law only allows initiation of reorganisation proceeding over each single distressed company within a group of companies which may raise practical obstacles in case the reorganisation is to be conducted over the group of companies.

On the other hand, there have been noteworthy positive changes. New Consensual Financial Restructuring Law was passed in 2015 allowing for a creditor and a debtor to execute Consensual Financial Restructuring Agreement providing for the Serbian Chamber of Commerce to act in capacity of the institutional mediator. However, due to ineffectiveness of the 2011 Law, outcomes of the new legislation can not be predicted with certainty.

In addition, by amendments of the tax regulations, the more lenient conditions for recognizing write-offs of NPL in banks' tax balance have been introduced.

For the mentioned issues to be favourably resolved, in near future it will be paramount that substantive regulatory and non-regulatory changes take place. Some changes regarding tax treatment of NPL and financial restructuring have already been made. In addition the NBS relevant decisions have been amended and supplemented in order for sustainable restructuring practice to be encouraged. Rendering the Strategy was an important step in order to set out the most essential NPL issues. The Strategy implementation is now a matter of practical commitment and cooperation of relevant institutions and stakeholders.

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