

**Survey of the Legal and Regulatory Environment
for Microfinance Institutions in the Republic of Serbia**

**By:
Kate Lauer and Timothy R. Lyman**

April 2, 2002

This Survey (including its Appendices) is not intended to constitute legal advice. To the best of the authors' knowledge, the contents of this Survey are current as of the date above, but do not include any developments subsequent to that date. The sources of information on which the authors relied are outlined in the text and footnotes of the Survey.

Table of Contents

	<u>Page</u>
PRELIMINARY NOTE.....	1
I. INTRODUCTION.....	2
II. SITUATION ANALYSIS AND SUMMARY CONCLUSIONS.....	2
A.CURRENT LANDSCAPE OF MICROFINANCE PROGRAMS.....	2
B.NBY'S POSITION ON MICROFINANCE.....	3
C.OTHER POLICY MAKERS' AND DONORS' POSITIONS ON MICROFINANCE.....	5
D.GENERAL PROSPECTS FOR MICROFINANCE IN SERBIA.....	5
III. LEGAL FORMS.....	6
A.BANKS AND OTHER FINANCIAL ORGANIZATIONS.....	6
1.GENERAL.....	6
2.BANKS.....	7
3.SAVINGS BANKS.....	14
A.ENTERPRISES.....	15
1.GENERAL.....	15
2.FOUNDERS.....	15
3.PERMITTED PURPOSES AND ACTIVITIES.....	15
4.ACCESS TO CAPITAL.....	16
5.MANAGEMENT.....	16
6.REPORTING.....	16
7.TAX TREATMENT.....	16
8.LEGAL FEASIBILITY OF TRANSFORMATION.....	17
B.NONPROFIT LEGAL FORMS.....	18
1.GENERAL.....	18
2.ESTABLISHMENT AND FOUNDERS.....	19
3.PERMITTED PURPOSES AND ACTIVITIES.....	19
4.ACCESS TO CAPITAL.....	20
5.SUPERVISION; REPORTING.....	20
6.TAX TREATMENT.....	20
7.LEGAL FEASIBILITY OF TRANSFORMATION.....	21
IV. LENDING ACTIVITIES AND COLLATERAL.....	22
A.LENDING ACTIVITIES	22
B.INTEREST RATES.....	22
C.COLLATERAL.....	22
Appendix A – Assessment and Recommendations.....	A-1
Appendix B – Legal and Political Context.....	B-1
Appendix C – Sources Consulted.....	C-1
Appendix D – Persons Consulted.....	D-1
Appendix E – Translation of NBY Letter.....	E-1
Appendix F – Legislative Reform Projects.....	F-1

List of Abbreviated Terms

DFID – Department for International Development

DRC – Danish Refugee Council

EBRD – European Bank for Reconstruction and Development

FX – Foreign exchange

IFC – International Finance Corporation

ICNL – International Center for Not-for-Profit Law

IRC – International Rescue Committee

JSC – Joint stock company

LLC – Limited liability company

LoB – Law on Banks and Other Financial Organizations

MFB – Microfinance Bank

MFC – Microfinance Centre for Central and Eastern Europe and the Newly Independent States

MFI – Microfinance institution

NBY – National Bank of Yugoslavia

NGO – Nongovernmental organization

SMEs – Small and medium-sized enterprises

UNHCR – United Nations High Commissioner for Refugees

USAID – United States Agency for International Development

YUM – Yugoslavian dinar

VAT – Value Added Tax

ZOP – Zavod za obračun i plaćanja (Yugoslav Agency for Money Circulation and Payment)

Preliminary Note

The authors of this Survey, Timothy R. Lyman and Kate Lauer, are lawyers who are members of the bars of Connecticut and New York, respectively. Neither is a member of the Serbian bar. However, they have worked on this project with two lawyers who are members of the Serbian bar: Mr. Aleksandar Preradović and Ms. Ines Matijević (referred to in this Survey as local counsel). Both Mr. Preradović and Ms. Matijević are associated with the Belgrade office of the English law firm Harrison's Solicitors.

Local counsel supplied the authors with the English translations of the laws listed in Appendix C (other than (i) the Act on Social Organizations and Associations of Citizens and the Law on Legacies, Foundations and Funds, both of which were provided by the International Center for Not-for-Profit Law and (ii) the 2000 Law on Executing Proceedings (excerpts), which was supplied by the EBRD¹) and attested to their accuracy, completeness and current legal effect.

In addition, local counsel attended most of the interviews with the persons listed in Appendix D; reviewed and summarized for the authors the contents of various legal provisions not listed in Appendix C; and reviewed the text of this Survey in final draft form and confirmed all statements made therein about Serbian law and regulation and its current interpretation.

¹ Neither the ICNL nor the EBRD is responsible for any error in any of these translations.

I. Introduction

This Survey outlines the legal and regulatory environment for microfinance institutions² (MFIs) in the Republic of Serbia. The Survey, together with the Assessment and Recommendations (attached as Appendix A), was commissioned by the Microfinance Centre for Central and Eastern Europe and the Newly Independent States (MFC) and financed by the UK Department of International Development and the Belgrade office of UNHCR through its implementing partner, the International Rescue Committee (IRC).³

The material in the Survey is based on (i) a review of English translations of relevant legislation of both the Federal Republic of Yugoslavia (FRY or Yugoslavia) and the Republic of Serbia (listed in Appendix C), (ii) legal advice and assistance from two members of the Serbian bar, Mr. Aleksandar Preradović and Ms. Ines Matijević, and (iii) interviews with officials of the Legal Department of the National Bank of Yugoslavia (NBY), the Federal Ministry of Foreign Economic Relations, the Serbian Ministry of International Economic Relations, the Serbian Ministry of Economy and Privatization, the Serbian Ministry of Social Affairs, the USAID-funded advisor to the NBY Bank Supervision Department, donors and microfinance practitioners (names are listed in Appendix D).

II. Situation Analysis and Summary Conclusions

A. Current Landscape of Microfinance Programs

Microfinance in Serbia is currently conducted through three international NGOs that operate microlending programs under the protection of a bilateral agreement between Yugoslavia and UNHCR.⁴ Loans under these programs are disbursed and repaid through servicing agreements with commercial banks. Without the type of protection afforded by the UNHCR bilateral agreement, no legal entity may engage in lending activity in Serbia without a license from the NBY. Unlicensed lending is subject to criminal sanctions (i.e., fines and jail sentences). NBY licenses are available only to a very limited range of institutional types, and licenses may be denied at the discretion of the NBY. UNHCR and its implementing partners have an obvious interest in pursuing regulatory liberalization to permit microlending through locally registered NGOs without dependence on the protection of bilateral agreements. Each of the implementing partners has formed a local citizens' association for this eventual purpose.

² The term "microfinance institution" is used here without regard to the legal form of the institution in question, and refers to any legal entity engaged in providing financial services to lower income persons and their businesses as its primary activity. This Survey also addresses microfinance activities carried out by other types of institutions, such as conventional commercial banks and international NGOs.

³ The laws and regulations relevant to microfinance -- and the prospects for legal and regulatory reform -- must be understood in the context of the unique legal and political situation that currently pertains in Serbia. The authors have included a brief description of the current situation in Appendix B.

⁴ The three NGOs are Oxfam, IRC and the Danish Refugee Council (DRC). Under the terms of their agreements with UNHCR, the UNHCR implementing partners are required to target their lending primarily or exclusively to refugees.

There are several commercial banks that engage in lending to SMEs, some using their own funds and others on-lending funds from international financial institutions. In April 2001, EBRD and others formed a commercial bank, the Microfinance Bank (MFB), which specifically targets its services to smaller businesses and entrepreneurs. However, neither MFB nor any other commercial bank is presently doing any lending in amounts small enough to be reasonably characterized as microlending.⁵

Recently, an affiliate of Opportunity International, which is planning to engage in microlending in Serbia (using capital provided by USAID), submitted an application to the NBY for a savings bank license. The NBY denied the application citing three specific defects. One might infer that the defects might be remedied (or at least that other applications for savings bank licenses planning to engage in microfinance might be granted). However, public and private statements of various NBY officials, including several of its top officials, suggest that the NBY may (at least for the timing being) use its virtually unrestricted regulatory discretion to deny new savings bank licenses, as discussed further below.

Other recent initiatives to establish new microfinance programs or MFIs in Serbia have been temporarily postponed or discouraged as they face the fundamental problem of a lack of a workable legal vehicle (and the NBY's apparent current lack of interest in addressing this problem, as discussed further below). Two of these initiatives are projects of Mercy Corps and the World Bank. Mercy Corps wants to set up a microlending program through a locally registered NGO; the World Bank has proposed a substantial program to foster the development of, and provide capital for on-lending to, NGO microlending implementing partners.

B. NBY's Position on Microfinance⁶

The NBY's present apparent lack of interest in microfinance and the development of NGO-based microlending in Serbia seems to be heavily influenced by its current focus on cleaning house in the banking system. The NBY, together with the Agency for Deposit Insurance and Bank Rehabilitation, Bankruptcy and Liquidation, is engaged in a program that involves closing and liquidating or consolidating Serbia's many insolvent banks. The NBY closed the four largest banks in Serbia in January 2002. High-ranking NBY officials have made both public and private statements to the effect that during the current critical phase of this process, only an extremely limited number of new commercial banking licenses will be approved by the NBY and no new savings bank licenses can be expected. It appears that, in this environment, the NBY does not want to

⁵ As discussed below, MFB is interested in regulatory liberalization and reform. However, the problems it faces under current regulations -- many of which relate to the restrictions on lending in foreign currency -- are common to all commercial banks with foreign currency borrowings and do not relate specifically to MFB's targeted SME clientele.

⁶ The authors did not meet with the Governor or Deputy Governor of the NBY, or with the chief spokesperson and policy maker for the Legal Department of the NBY (none of whom was available for meetings). However the authors did meet with a member of the Legal Department staff who had been thoroughly briefed on the Department's current position (as well as the position of the Governor and Vice Governor) regarding microfinance.

increase the number of operational financial institutions, regardless of their character and objectives.

The NBY's current position on microfinance institutions is spelled out in a letter sent in October 2001 by the Deputy Governor to the Serbian Ministry of Economy and Privatization in response to an initiative spearheaded by that Ministry to liberalize the microfinance operating environment. Specifically, the Ministry proposed the passage of a decree authorizing NGO-based microlending in Serbia.⁷ (A translated copy of the letter is attached as Appendix E.) In the letter, the NBY suggests at least two major factors underlying its lack of interest in permitting non-bank microlending activity:⁸

- The letter inappropriately equates donor-financed, *non-depository* NGO-based microlending with "loosely regulated" *depository* financial institutions that the NBY holds responsible for triggering the hyperinflation and the destruction of the monetary system in Serbia in the early 1990s; and
- The NBY wants to use the state-owned National Savings Bank (which will, as of 2003, include the branches of the state-owned payment agency, Zavod za obračun i plaćanja (ZOP)⁹) to carry out microlending through the on-lending of donor funds.

In lumping non-depository NGO-based microlending together with all forms of depository financial institutions, the NBY's present stance is at odds with the recommendations of the USAID-sponsored advisors to the NBY's Bank Supervision Department. The advisors have recommended that the NBY support passage of a new banking law that would limit NBY's licensing and prudential supervision exclusively to *depository* financial institutions. The advisors' motivation in proposing this course of action is primarily driven by the desire to encourage wise use of the NBY's limited resources (as opposed to the desire to broaden and deepen the Serbian financial sector). However, their recommended changes would also likely result, over time, in such a broadening and deepening. Thus far, the NBY has rejected the recommendation. The

⁷ In the fall of 2001, UNHCR and its microfinance-implementing partners initiated a dialogue with officials within the SME Department of the Serbian Ministry of Economy and Privatization in an attempt to identify a means of permitting NGO-based microlending in Serbia, looking ahead to UNHCR's eventual exit from the country and the loss of protection under the UNHCR bilateral agreement. The Ministry proposed an initial draft decree, basing it on a Montenegro decree that authorizes microlending activities by Montenegrin NGOs despite the Yugoslav Law on Banks. The Ministry's proposed decree was soon brought to the attention of the NBY.

⁸ The views presented in the letter have also -- according to various people interviewed by the authors -- been repeated by other officials within the NBY.

⁹ Currently ZOP, which is housed within the NBY, is the designated agency through which all payments and collections are to be made. (Under the Law on the NBY, the NBY is responsible for both foreign payment operations and domestic payment operations.) The use of ZOP for this purpose actually discouraged use of the payment system (and encouraged cash transactions) because (i) it was expensive and (ii) it provided information used for the purpose of collecting taxes. As of January 2003, all payments will be made through the commercial banks. It is expected that the remaining ZOP structure (i.e., shed of its branches) will function as the national depository for shares.

current NBY proposals for amendments to the Law on Banks (expected to be considered by Parliament in March and April 2002) do not include any liberalization vis-à-vis non-depository financial institutions.

C. Other Policy Makers' and Donors' Positions on Microfinance¹⁰

There is widespread interest elsewhere in government, at both the federal and republican level, to broaden and deepen the financial sector and reach lower income people and businesses. At the republican level, top officials of the Ministry of Social Affairs, the Ministry of Privatization and Economy and the Ministry of International Economic Relations support the development of an enabling legal and regulatory environment for microfinance. Support from the Ministry of International Economic Relations is particularly important in light of its leadership role in ongoing economic and commercial law reform as well as the working relationship it is forging with its federal counterpart. The federal Ministry of Foreign Economic Relations may, in turn, play a key role in encouraging federal parliamentary consideration of relevant reform legislation prepared by its republican counterpart ministry.

There is also strong interest in donor community for both the development of a robust microfinance sector in Serbia and legal and regulatory reform necessary to allow its development. However, no donors with whom the authors consulted expressed specific interest in contributing funds to a state-controlled microfinance program, such as the one proposed in the NBY's October letter to Ministry of Privatization and Economy. Instead, donor interest seems to be focused on an increase in private sector microfinance activity and accomplishing the reforms necessary to make this both legally and practically feasible.

D. General Prospects for Microfinance in Serbia

Notwithstanding the current position of the NBY, the interest from donors and other parts of the public sector in Serbia suggests relatively good prospects for improvements to the legal and regulatory options for microfinance institutions in Serbia. It is important to note, however, that the NBY's concern not to repeat the economic chaos of the early 1990s is both entirely legitimate and entirely addressable. Education and awareness-building are needed to show specifically how the financial sector can be broadened and deepened *without* jeopardizing its safety and soundness. At the same time it appears unrealistic to expect a near-term opportunity for any kind of "quick fix" that would open up easy legal and regulatory options for forming and operating MFIs (such as the decree proposed by the Serbian Ministry of Privatization and Economy last fall). Instead, the education and awareness-building exercise will need also to include work on concrete legislative reform proposals that balance appropriately the objective of increasing financial service delivery to lower income clients against the goals of maintaining and improving the safety and soundness of the financial sector as a whole.

¹⁰ The authors were unable to schedule a meeting with representatives of the Serbian Ministry of Finance and also did not meet with Federal Ministry of Finance (which is currently without a Minister and, according to local counsel, is not currently taking a leadership role on financial sector legal and regulatory policy issues).

In the meantime, work is needed on strategies to allow the existing organizations engaged in (or pursuing starting) microfinance programs in Serbia to continue. As in most other countries in the region, creative use of bilateral agreements (which have the status of treaties and therefore "trump" inconsistent legislation and regulations) is likely to be the most convenient and workable vehicle in the short term.

The authors' detailed recommendations, as well as proposed interim operating strategies, are discussed in Appendix A.

III. Legal Forms

A. Banks and Other Financial Organizations

1. General

The federal Law on Banks and Other Financial Organizations (LOB or Law on Banks) governs the licensing and operations of banks and other financial organizations. The term "bank" includes branches of foreign banks that have been issued an operating permit by the NBY. The term "financial organizations" is defined to include the following four legal forms: the Postal Savings Bank, savings banks, savings and credit organizations, and savings and credit cooperatives.

As noted above, current law is interpreted to prohibit monetary lending¹¹ activity by any legal entity not licensed pursuant to the Law on Banks. This Survey focuses on only two of these different possible legal forms described in the LOB: banks and savings banks. The other three possible legal forms are inappropriate vehicles for microfinance for the following reasons:

(i) *The Postal Savings Bank.* The Postal Savings Bank may only be owned by PTT services enterprises, the federal state, member republics (Serbia and Montenegro) and "other legal entities [whose] line of business is of importance to the PTT services system." (LoB, Art. 61)

(ii) *Savings and credit organizations.* The LoB limits the permitted operations of a savings and credit organization. (A savings and credit organization is, in effect, a "captive" credit union for the employees of its founder enterprise that also serves the financing needs of its founder.) A savings and credit organization may only engage in the following: (i) collecting funds towards financing the sale of specified goods and services produced or provided by its founders, (ii) taking savings from employees of its founders, (iii) extending credits for the needs of its founders, (iv) performing payment

¹¹ The Law on Contract and Torts permits the lending of property other than money by persons and legal entities that do not have a license from the NBY.

operations (in conformity with federal law¹²) and (v) other banking operations required by the employees of its founders.

(iii) *Savings and credit cooperatives.* Savings and credit cooperatives may be founded only by other cooperatives¹³ and their members. In addition, a savings and credit cooperative may only take savings from individuals and may only perform other banking operations for individuals (i.e., not legal entities). Finally, a savings and credit cooperative may only extend credits within the scope of its founders' activity.

2. Banks

a. Ownership

All banks are formed as stock companies and must have at least two founders. Any individual or legal entity may have an equity interest in a Serbian bank, provided that only foreign persons from a jurisdiction with reciprocal rights (i.e., a Yugoslav may be an owner of a bank formed under the laws of the foreign jurisdiction) may found and be an owner of a bank in Serbia. Any foreigner must contribute its capital (excluding non-monetary contributions) in foreign currency. Capital contributions beyond the minimum capital requirement may be made in non-monetary form.¹⁴ While the authors are aware of no precedent, it might be possible (as has been done in other countries) to contribute loan assets (or an entire loan portfolio) to a bank in exchange for shares.

A shareholder must obtain NBY approval before acquiring a 15% interest in a bank. As stated in the LoB, the NBY "shall give [its] approval" if the buyer has a good credit rating. (LoB, Art. 12) There currently are no objective criteria regarding a good credit rating. If the NBY does not give its approval within the specified period of 30 days, then the application shall be deemed rejected.

A bank is required to notify the NBY of any sale of the bank's shares if, as a result of such sale, a person acquires more than 10% of the initial capital. Such notice must be provided within five days after the date of sale.

The provisions of the Enterprise Law relating to protection of the rights of minority shareholders (10% or more of the authorized capital), liability for damage and shares with multiple owners apply to banks and other financial organizations.

b. Permitted Purposes and Activities

¹² Federal law currently requires that all payments be channeled through the ZOP. As of January 2003, the commercial banks will be responsible for payment operations.

¹³ The Law on Cooperatives governs the formation and operation of cooperatives generally in Serbia. However, that law explicitly provides that the Law on Banks governs the formation, organizational structure and operation of savings and credit cooperatives.

¹⁴ The value of the assets being contributed must be assessed by an authorized valuation expert. Previously, the Director of Privatization was responsible for maintaining a list of authorized valuation experts. Today, no Ministry or other official has explicit responsibility.

As specified in the LoB, a bank may engage in the following banking operations:

- Taking deposits;
- Extending credits;¹⁵
- Foreign exchange operations (with proper authorization under federal law);
- Issuing securities and credit cards;
- Safekeeping of assets and securities;
- Purchasing and selling securities;
- Issuing sureties, guarantees and backing guarantees and other warranties;
- Providing payment services.

A bank may engage in foreign payment operations as well as foreign exchange and currency transactions and exchange office operations if it obtains authorization under the Foreign Credit Transactions Law and the Foreign Exchange Transactions Law. While a resident bank may (theoretically) lend abroad pursuant to the Foreign Credit Transactions Law, it may not lend to a resident except in connection with exports.¹⁶

In addition, a bank may carry out the following operations in accordance with the relevant federal law: (i) securities brokerage services, (ii) buying and collecting claims and (ii) provision of other financial services.

A bank may hold equity interests in other legal entities, provided that the total "permanent investment" by a bank in the shares of enterprises and banks does not exceed 15% and 51% of the bank's capital.¹⁷ A bank is required to notify the NBY of any permanent investment in shares of enterprises and other banks as well as any permanent investment in its fixed assets.

c. Access to Capital

Banks have access to capital through (i) share issuances, (ii) deposits, (iii) general borrowings and (iv) issuances of commercial paper. If a bank borrows foreign currency from a non-resident, it must register the loan with the NBY. In addition, banks have access to short-term loans from the NBY.

A bank may issue preference shares; however, the total par value may not exceed 30% of the bank's share capital.

d. Management; Branches

¹⁵ However, a bank may not extend credits to its shareholders during the first year following its entry in the court register.

¹⁶ The NBY clearly keeps a tight control over all foreign exchange transactions. In addition, the national balance of payments projection (set by the Yugoslav Parliament) governs the maximum total foreign exchange investments companies and sole proprietors may make in their foreign operations as well as the amount of foreign exchange that such companies and sole proprietors may bring into Yugoslavia in the form of profit.

¹⁷ There are no criteria for an investment to be deemed "permanent."

(1) Management

A bank is managed by (i) a board of directors, which is responsible for general management (other than those matters in the exclusive purview of the shareholders), (ii) a supervisory board and (iii) a manager.

The members of a bank's board of directors are elected from the founders and shareholders who hold common shares. Any person who, as a representative of one of the bank's founders or shareholders, has been elected as board member shall be removed if the legal entity that he represents ceases to be a shareholder with controlling rights or if his employment with such shareholder has been terminated.

The members of a bank's supervisory board are elected from the shareholders and other bank specialists. However, a member of a bank's board of directors may not also simultaneously serve as a member of the bank's supervisory board. A person may not serve on the supervisory board of a bank if he or she has been convicted of a felony that would make him or her unfit for the position.

A person may not serve on the board of directors, the supervisory board, any other bank committee or as manager if he or she serves in such capacity with respect to any other bank or financial organization. In addition, a person may not serve on a bank's board of directors or supervisory board if, at any time in the prior ten years, he or she had a "contractual relationship" or was employed by a bank or other financial organization whose license was revoked by the NBY.

Generally, the manager must have experience in banking and finance and must not have been sentenced to a felony prison term for committing a crime in his official duties. In addition, it is expected that she or he has at least three years of work experience (although five years is the usual practice) in the area of banking and finance and knows at least one foreign language.

The Law on Banks does not require a bank to have an audit committee nor does it explicitly provide for an internal supervision unit.

(2) Branches

A bank shall inform the NBY regarding the establishment of branches, business units and representative offices in Serbia. (There currently is no requirement to get NBY approval prior to establishing a branch.) A bank must obtain the prior approval of the NBY prior to opening a branch, business unit or representative office abroad.

e. Audits; Reports; Disclosure

(1) Audit

A bank shall be audited annually by an auditor duly licensed by the Federal Ministry of Finance. (The auditors are required to submit to the Federal Ministry of Finance each month a list of the companies that it audits.) A copy of the auditor's report shall be presented to the supervisory board of the bank and to the NBY.

(2) Reports

The NBY has quite burdensome reporting requirements which include the following:

- Daily reports on foreign exchange (FX) correspondent accounts; transit accounts for FX incoming money transfers and FX cash; and monetary aggregates (requiring daily amounts for YUM cash, total loan portfolio, loans in arrears, fees in arrears, loan loss provisions, YUM current accounts and YUM term deposits); and
- Reports submitted every ten days for FX cash turnover and a special "coded report" summarizing information about the loan portfolio (e.g., short-term loans to companies and to individuals, long term loans).

While, as noted by one bank, these reports may be "standard" for existing banks, they are time-consuming and require significant initial expenditures for establishing a reporting system (thus being a potential deterrent for new entrants).

(3) Disclosure

Each bank is required to publish yearly (in a daily newspaper) its financial statement and its profit and loss statement from the latest audit together with the auditor's opinion. However, there is no requirement that the banks disclose on a regular basis information regarding their performance as well as the terms and conditions for accepting deposits and providing loans.

f. Licensing; Corrective Action; De-Licensing

All banks as well as other financial institutions are licensed by the NBY. To be licensed as a bank, an applicant must, among other things: (i) submit to the NBY the required documents (including a five-year business plan for the bank and the fundamentals of the business policy for the first year of operation); (ii) provide a statement that the domestic founders will pay the monetary portion of the initial capital into an account with the NBY and a statement by the foreign founders (if any) that they will pay the foreign exchange into a special account with the NBY; (iii) demonstrate proof of transfer of any non-monetary assets to the initial capital of the bank and, with respect to any foreign founder, proof of the origin of the foreign investment and of the existence of reciprocity; and (iv) provide information regarding the founders' credit ratings and their control relationships and regarding the proposed bank's staff and

equipment.¹⁸ The NBY shall make its decision regarding whether to approve an application (i.e., whether it met the statutory requirements and whether the bank's "founding is justifiable" (LoB, Art. 9) within 60 days of the application filing date. The Governor of the NBY has absolute discretion regarding its approval or denial of an application.¹⁹ The bank shall apply for entry in the court register within 45 days after receiving NBY approval for an operating license.

The NBY shall revoke a bank's operating license if the NBY finds that: (i) the license was issued based on fraudulent information about the founders; (ii) the bank does not apply for entry in the court register within the 45-day period referred to above or it does not commence operations within 60 days after its entry in the court register; (iii) the bank fails to meet the minimum capital requirement or has fewer founding shareholders than the required number; (iv) the bank does not permit the NBY or an authorized auditor to audit its operations; or (v) the bank is not conducting its operations in conformity with federal law and is not presenting the NBY with the required reports and data relating to its operations. As with the Governor's decision to reject a license application, the decision to revoke a license is within the Governor's discretion and is "final" as an administrative act (and therefore is not appealable pursuant to an administrative procedure), but it may be appealed in court. If a license is revoked or withdrawn, then the bank must be liquidated.

The NBY may order a bank or other financial organization that has violated NBY regulations or monetary policy in a way that endangers its financial situation to correct its actions. The NBY may also order the bank or other financial institution to take various measures, including (i) to discontinue temporarily the financing of certain founders or clients, (ii) to stop granting loans for a specified period of time or (iii) to write off claims. If the bank fails to follow the instructions of the NBY or repeats the violation within 180 days from the delivery of the NBY's decision on the measures to be taken, the NBY shall commence with the collection of all of its claims from the bank and shall decide whether to revoke the license of the bank and initiate bankruptcy and/or liquidation proceedings.²⁰

g. Prudential Regulation and Supervision

All banks are regulated and supervised by the NBY. In connection with its supervision responsibilities, the NBY has the right to examine the books and other

¹⁸ In the event of a merger of two banks, the merged banks apply for an operating license by submitting information on the merger, restated financial statements for the merged entities, names of recommended members of the merged bank's board of directors and supervisory board and other materials.

¹⁹ While the Governor's decision to deny an application is "final" as an administrative act (and therefore is not appealable pursuant to an administrative procedure), the decision may be appealed in court.

²⁰ Although there exists a federal "Act on Compulsory Composition with the Creditors, Bankruptcy and Liquidation," the federal Ministry of Justice is currently working on a new law on bankruptcy and liquidation (as noted in Appendix F). As noted below, one of the recommendations of the USAID-sponsored advisors to the NBY Bank Supervision Department includes moving the bank liquidation procedure from the courts' purview to that of the Federal Agency for Deposit Insurance and Bank Rehabilitation.

documentation of banks and other financial organizations as well as the documentation of the clients of such institutions.

NBY regulations cover the customary prudential matters, including (i) the minimum capital requirement (currently the YUM equivalent of \$5 million); (ii) capital adequacy requirements; (iii) liquidity requirements; (iv) credit exposure limits that apply generally, to insiders and to the top borrowers; (v) provisioning; and (vi) foreign reserves management.

Both the USAID-sponsored advisors to the NBY Bank Supervision Department and MFB have proposed various changes to the current law and regulations applicable to banks. The USAID-sponsored advisors have made specific recommendations for substantial changes to the Law on Banks and the regulations.²¹ The advisors place primary emphasis on the NBY having the legal authority to require banks to adopt sound risk management policies and procedures (i.e., shifting the focus from compliance with specific rules and ratios to more analysis and control of risk). The advisors also focus on the following much-needed changes: improving the licensing requirements, including the adoption of "fit and proper" criteria of managers, directors and other control persons; increasing the focus on control groups; improving corporate governance provisions (including requiring each bank to have an audit committee); adopting a strict "fiduciary duty" standard for directors and senior managers; prohibiting transactions that give preference to insiders; enhancing NBY's enforcement authority (e.g., corrective action in a situation that could endanger the depositors regardless of whether a rule had been violated); supporting "consolidated supervision" (i.e., ability to collect information from significant participants and related entities of banks); and improving procedures for bank liquidation.

In meetings with the top officials in the NBY, MFB has raised many concerns regarding specific regulations that are seriously impeding the growth of MFB's business. However there are two particularly difficult obstacles that it faces as a new bank with significant foreign borrowings.

Restriction on lending in foreign currency. Banks must typically comply with the central bank limits on their open currency position.²² (The NBY has set the limit at 5%.) If a bank's borrowings are primarily denominated in foreign currency (which is the case for MFB and others) and its loan assets are primarily denominated in YUM (which is the case for MFB as well as most other banks in Serbia due to restrictions on lending in foreign currency), then the bank's ability to expand its lending business is severely constricted. MFB has recommended that the NBY loosen the restrictions on lending in foreign currency or treat indexed YUM loans as an FX asset.

²¹ While NBY is in the midst of proposing certain amendments to the Law on Banks (the amendments are expected to pass in early April 2002), they will not address the bulk of the changes recommended by the NBY's advisors.

²² A bank's "open currency position" is the difference between its FX assets and FX liabilities. A 5% limit means that the open currency position (the excess of the bank's FX liabilities over its FX assets or the amount that the bank is "exposed" with respect to foreign currency) may not exceed 5% of the bank's FX liabilities.

Liquidity Reserve Requirements. The second obstacle raised by MFB is NBY's implementation in 2001 of additional liquidity reserve requirements (on top of the already applicable 24.5% minimum reserve requirement). With respect to individuals' YUM-denominated deposits, banks must now maintain a specified percentage of liquid YUM-denominated assets (i.e., bank deposits, cash or NBY treasury bills). The percentage varies depending on the maturity of the deposits. However, for current accounts, a bank must set aside 20% in liquid YUM assets. In addition, all banks other than "prime banks"²³ must set aside a 50% reserve for foreign currency deposits of individuals. (The NBY pays an interest rate of 3% on these reserves.) As one of its founding members, EBRD is actively engaged in pushing forward with MFB's issues.

h. Tax Treatment

A bank pays a service sales tax on, among other things, banking and other services, money transfer services and stock exchange services. The tax is based on the commission or fee paid to the bank.²⁴ Banks also pay an enterprise profits tax and property taxes. (See Section III.B.7 below for a discussion of application of such taxes to JSCs generally.)

For purposes of calculating the enterprise profits tax, the banks may deduct reserves for provisioning (in addition to the deductible expenses applicable to all JSCs). A bank may either take a lump sum provision (which may not exceed 3% of gross receivables) or specific provisioning (100%).

i. Deposit Insurance

A bank is required to insure individuals' deposits and must pay the insurance premiums. Companies' deposits are not insured.²⁵ Deposits are insured by the Agency for Deposit Insurance and Bank Rehabilitation, Bankruptcy and Liquidation. The maximum insured amount has not kept pace with inflation and today stands at YUM 5,000 (approximately \$80).

j. Transformation

Under Yugoslav law, it is not possible for an existing operational JSC to file an application for a banking license. (Registration as a JSC that will operate as a bank cannot occur until the JSC has procured its banking license.)

²³ A prime bank has a rating of AAA to A, as defined by Moody's. No bank domiciled in Serbia meets that standard at present.

²⁴ There is also a "financial transactions tax" which is assessed on cashless payments made through accounts. The transferor (or payor) pays the tax.

²⁵ When the NBY closed the four largest banks in January 2002, the government (with the permission of the IMF) partially covered the deposits of companies. (Deposits of government entities and organizations covered by the government budget, such as hospitals, were fully covered.) However, according to Kathryn Woolford, Chief of Party of the Bank Supervision Project, it is unlikely that this type of action will be repeated.

According to the KPMG Managing Partner responsible for tax matters in the Belgrade office, Nina Bulatović, it is not clear under current law and practice whether an exchange of shares for assets (e.g., a loan portfolio) would constitute a taxable event.

3. Savings Banks

a. General

Savings banks are subject to many of the same provisions of the Law on Banks as are regular banks. The information provided with respect to banks in paragraphs d, e, f, g, h, i and j of Section 2 above applies equally to savings banks. The discussion below focuses on distinctive features of savings banks.

b. Ownership

A savings bank, which must have minimum capital equal to the YUM equivalent of \$1,000,000, may be founded only by the federal state, member republics, towns, municipalities, domestic legal entities and domestic persons. Thus a foreign organization or person may not be a founder of a savings bank without using a Serbian intermediary. While it is possible for a foreigner to acquire a Yugoslav legal entity and use that entity to file the application for a license (provided that such legal entity has at least one year of financial statements), this arrangement presents its own difficulties. Specifically, if the acquired organization has no business history (i.e., if it is a shell organization), then the NBY may be unwilling to approve the organization's "creditworthiness."²⁶

c. Permitted Purposes and Activities

A savings bank may collect savings (in YUM) only from natural persons. While it may extend credits to both natural persons and legal entities, its credits to legal entities must be for "improving housing construction and public utilities and development of entrepreneurship." (LoB, Art. 67.) This credit purpose limitation presents an obvious problem for MFIs wanting to extend consumer loans.

d. Access to Capital

A savings bank has access to capital through (i) share issuances, (ii) deposits and (iii) loans and commercial paper. According to local counsel, it is not entirely clear under current law whether a savings bank may borrow in foreign currency from a non-resident. However, if it were possible, the loan would need to be registered with the

²⁶ This was one of the three reasons given for the rejection of the application to establish a savings bank that was submitted by an affiliate of Opportunity International (OI). OI chose the savings bank form upon the advice of NBY Deputy Governor Jelasic, after discussing its microlending plans with him. In the fall of 2001, OI acquired an LLC which then founded the JSC that would have been the savings bank. (The LLC held 99% of the shares of the JSC.) The LLC had been in existence for several years but had virtually no operating history.

NBY. A savings bank may also issue preference shares; however, the total par value may not exceed 30% of the bank's share capital.

A. Enterprises

1. General

As noted previously, currently only banks and other financial organizations licensed by the NBY may engage in monetary lending activities. Yugoslav law does not, at present, contemplate the possibility of an unlicensed finance company. The discussion set forth below serves to outline the existing legal forms that might be used if the Law on Banks were amended to permit the operation of finance companies without a license from the NBY.

The Yugoslav Enterprise Law describes three classes of enterprise:²⁷ "socially-owned" enterprises, public enterprises and economic associations. Only economic associations are relevant for the purposes of this Survey. An economic association can be formed as a partnership (general and limited), joint stock company or limited liability company. As a partnership is generally not an appropriate or practical vehicle for microfinance, this report will address only JSCs and LLCs, either of which could be a suitable legal form for an MFI if the NBY licensing requirement is loosened or lifted.²⁸

2. Founders

Individuals and legal entities may found a JSC or an LLC (and be shareholders thereof). Foreign legal entities and natural persons may found enterprises provided that (i) the jurisdiction where they are established or a citizen would permit a Yugoslav the same founding rights and (ii) it is permitted under Yugoslav federal law governing foreign investment.

3. Permitted Purposes and Activities

A company may conduct one or several lines of business, subject to meeting any separately specified requirements for the line of business in question and, if required by federal law, obtaining permission from the competent authorities (e.g., a bank first must obtain a banking license from the NBY, as noted above). While the Law of Contracts and Torts does not explicitly restrict the types of legal entities or persons who may make loans, it is understood that this refers to the lending of non-monetary assets, and that only banks and other financial institutions licensed by the NBY may engage in monetary lending.

A company may not hold foreign currency. Any foreign exchange earned by a company in accordance with the provisions of the Law on Foreign Exchange

²⁷ The Law defines "enterprise" as a legal entity that conducts business "for the purpose of making a profit." (Enterprise Law, Art. 1(1).)

²⁸ The term "company" is used in the text below to refer to both JSCs and LLCs.

Transactions must either be kept in the company's foreign exchange account with an authorized bank or sold to an authorized bank.

4. Access to Capital

Companies may raise capital through capital contributions,²⁹ the issuance of commercial paper and through general borrowings. The ability of a company to borrow foreign currency or borrow from a foreign organization is subject to the Laws on Foreign Credit Transactions and Foreign Exchange Transactions. A company may borrow in foreign currency from a resident bank, but only if the loan is to finance export-related activities. A company may borrow from abroad if the funds are to be used for (i) importing goods and services and financing capital projects abroad or (ii) another purpose approved by the NBY. All foreign credit transactions -- i.e., borrowings from abroad and lending abroad by Serbian banks -- and foreign currency transactions must be registered with the NBY.)

5. Management

The management bodies of a joint stock company or a liability company are (in addition to the general meeting of shareholders) (i) a board of directors, which is the "controlling body" (other than those matters in the exclusive purview of the shareholders), (ii) a general director and (iii) a supervisory board. The general director may be a member of the board of directors.

6. Reporting

JSCs and LLCs, other than small-sized enterprises (as defined in the Law on Accountancy),³⁰ must submit their annual reports as well as statistical and financial reports to the commercial court where they are registered.

7. Tax Treatment

JSCs and LLCs are subject to sales tax, the enterprise profits tax and property taxes. The Sales Tax Law includes a service sales tax (the taxpayer is the provider of the services), which is assessed on fee income. Services include "banking and other services." (Sales Tax Law, Art. 12) Presumably, if JSCs or LLCs were permitted to lend without a license from the NBY, they would be assessed a service sales tax on the services they provided.

²⁹ Capital contributions may be made in monetary or non-monetary form (securities, commercial paper as well as other property and rights having a monetary value).

³⁰ Art. 3(2) of the Law on Accounting defines small enterprises are those enterprises which, in the immediately preceding business year, fulfilled at least two of the following conditions: (1) the average number of employees was less than 50; (2) the annual profit was lower than sum of 8,000 times the average gross pre-tax monthly salary in FRY; and (3) the average value of the assets (based on the figures at the beginning and end of the business year) was lower than 6,000 times the average gross pre-tax monthly salary in FRY.

Under the Enterprise Profit Tax Law, both resident and non-resident companies pay an enterprise profits tax (of 20%) in Serbia.³¹ Residents are taxed on profit generated both in Serbia and abroad; non-residents are taxed only on profits generated through a permanent operating unit based in Serbia. A taxpayer shall pay withholding tax (at the rate of 20%) on dividends and shares in the profits of a legal entity as well as interest accrued to any non-resident taxpayer.

Recognized deductible expenses include: (i) depreciation of fixed assets; (ii) charitable donations for educational, cultural, humanitarian and other such purposes (up to 3.5% of total revenue);³² (iii) membership fees paid to associations; (iv) write-offs of bad debts; (v) interest on loans (excluding interest and related costs on loans extended to a permanent operating unit by a non-resident head office), with certain maximum thresholds (applicable to any taxpayer not a bank or other financial organization) for credit extended to the taxpayer by associated persons and legal entities; and (vi) positive revaluations (revaluation revenues greater than revaluation expenditures) that are credited to reserves under the applicable accounting rules. Losses may be carried forward for five years.

Any taxpayer whose newly established operating unit generates a profit in an underdeveloped region is entitled to an enterprise tax reduction for two years (in proportion to the share of such profit in the total profit of the enterprise).

JSCs and LLCs also pay property taxes to the extent that they own or have other specified rights (including, among other things, the right of use and occupancy and the right of time-sharing) with respect to real estate. However, property tax is not payable with respect to real estate that is used for humanitarian purposes. (It is not clear whether microlending to the poor would constitute humanitarian purposes under Serbian law.) There are additional exemptions applicable to certain real estate, including urban building land of a specified maximum size. Property tax is also paid (by residents only³³) on property rights related to registered shares and interests in LLCs.

8. Legal Feasibility of Transformation

A company may, given the necessary approval required by its charter, transform into a company of another type (i.e., from a JSC to an LLC). However, as noted above, the Law on Banks does not accommodate the possibility of an operating JSC applying for a banking license. As previously noted, banking license must be procured before the initial registration of a JSC that is intended to operate as a bank.

³¹ An enterprise is a resident if formed in Serbia or if it has its head office in Serbia. An enterprise is non-resident if formed outside of the territory of Serbia or if it has its head office outside of the territory of Serbia.

³² Expenditures for humanitarian purposes are recognized only if made through humanitarian organizations recognized for such purposes.

³³ An enterprise is deemed to be a resident if it was formed or has its head office in Serbia; conversely, an enterprise is non-resident if it was formed or has its head office outside of the territory of Serbia.

B. Nonprofit Legal Forms

1. General

As previously noted, currently only legal entities that may be licensed by the NBY under the Law on Banks may engage in monetary lending activities. Other than savings and credit cooperatives -- which are effectively treated for most purposes as JSCs³⁴ -- only a JSC may apply for an NBY banking license. Therefore, NGOs cannot, under any circumstance, make loans (except under protection of a bilateral agreement). The discussion set forth below outlines what nonprofit finance organizations might look like if a regulatory window were opened for these kinds of institutions to engage in microlending.

Serbian law provides for various forms of nonprofit organizations, including citizens' associations, legacies, foundations and funds. Neither legacies nor foundations are appropriate vehicles for microfinance. Legacies appear to operate effectively as estate vehicles.³⁵ Foundations may only be established with state resources.³⁶ Therefore, this Survey covers only associations and funds, either of which could be a workable legal form for an MFI if restrictions on unlicensed lending are loosened or lifted (although there are certain drawbacks to both).

Following roundtable meetings held in November 2001 among the Serbian Ministry of Justice, the Center for the Development of NGOs and the International Center for Not-for-Profit Law (ICNL), the Ministry of Justice formed a working group of representatives of the Ministry, ICNL and local NGOs, to work on a new republic level Law on Associations to replace the antiquated provisions of the existing law. The working group prepared a draft that has been submitted to the republican parliament and is expected to be discussed during the current the session (which commenced the final week of March 2002).³⁷ The draft, if adopted in substantially the form submitted to parliament, would represent a significant modernization of the basic provisions governing associations in Serbia. It would also make associations a significantly more attractive vehicle for microfinance, if the requirements for a NBY license to engage in any type of lending activity are loosened or lifted in the future. However, the authors were informed by several sources that NGO law reform, in general, has been a subject of some considerable political disagreement, and the eventual new provisions relating to

³⁴ Savings and credit cooperatives are formed under and governed by the Law on Banks which, in turn, refers to and applies the provisions of the Law on Enterprises applicable to JSCs. Savings and credit cooperatives are not formed under or governed by the Law on Cooperatives.

³⁵ A legacy may be established only by individuals (foreign and domestic) with privately owned resources and must be managed by its founder or, according to the will of the founder, by another individual or individuals. Upon the death of the founder, the legacy is to be managed by the "socio-political community."

³⁶ A foundation may be established only by legal entities. Other legal entities and individuals (including foreign individuals) may join already-established foundations.

³⁷ There is also a draft federal law on the operation of foreign non-governmental organizations in FRY that has been the subject of considerable discussion among the organizations that it would govern.

associations, if a new law is passed, are difficult to predict. This Survey focuses, therefore, on the relevant provisions of existing law applicable to NGOs.

2. Establishment and Founders

A citizens' association is a voluntary association whose members are "working people and citizens." Foreigners may only join associations of foreigners.³⁸ It must be established by at least ten people, none of whom have been convicted of a criminal offense or prohibited from participating in the establishment of such an association. A fund may be founded by individuals (foreign and domestic) *or* legal entities (foreign and domestic).

3. Permitted Purposes and Activities

a. Citizens' Associations

A citizens' association is a legal entity formed for the purpose of "developing ... creativity in social, humanitarian, economic, technical, scientific, cultural, educational, sports and other activities which are carried out in organizations of associated labor, local communities and socio-political organizations." (Act on Social Organizations and Associations of Citizens, Art. 4) It may acquire and use funds and dispose of funds for activities aimed at achieving the objectives set forth in its statute (articles of association). It may undertake only those activities which further the realization of its objectives, as set forth in its statute.

A citizens' association ceases operations (i) pursuant to a decision of its members, (i) if the number of members falls below the minimum, (iii) if the work it engages in is prohibited under the Act on Social Organizations and Associations of Citizens or (iv) if is determined by the competent municipal body that the association has ceased its activities.

b. Funds

A fund is to be established for the purpose of "stimulating creativity, accomplishment of humanitarian and other goals of public interest." (Law on Legacies, Foundations and Funds, Art. 2) In addition, funds may own real estate and goods and may dispose of rights and goods. The income from the rights and property may be used for the realization of its purposes.

A fund shall cease operations upon realization of its goal or exhaustion of its resources. The remaining resources, if any, are to be allocated according to the organization's constitutive documents or, if they are silent, then according to the founder or by the municipal assembly where the organization is established.

³⁸ The draft Law of Associations recently submitted to parliament by the republican Ministry of Justice would enable any three foreign or domestic individuals or legal entities to form and be members of an association (provided that at least one foreign founder has a legal presence in Serbia).

4. Access to Capital

A citizens' association may raise funds through membership fees, donations and in other manners permitted by law (including borrowing). A fund may be founded with state-owned resources, "private" resources or both and may raise additional funds through donations and borrowings.

As with an enterprise, the ability of a citizens' association or a fund to borrow foreign currency or borrow from a foreign organization is subject to the Laws on Foreign Credit Transactions and Foreign Exchange Transactions. As citizens' associations and funds are not involved in commercial activities nor are they generally involved in export-related activities, they may not borrow in foreign currency from resident banks or other financial institutions. (Resident banks and other financial institutions may only lend in foreign currency to Serbian residents for export-related purposes (i.e., for importing goods and services necessary for export-related production).) However, citizens' associations and funds are permitted to borrow in foreign currency from abroad for purposes approved by the NBY. As noted above, all foreign credit transactions -- i.e., borrowings from abroad and lending abroad by Serbian banks -- must be registered with the NBY.

5. Supervision; Reporting

The governing legislation does not provide specifics regarding government oversight over either citizens' associations or funds. Citizens' associations must register with the Municipal Department of the Ministry of the Internal Affairs (in practice, the municipal police). Information in the registry (including the articles of association and the minutes of the founding assembly) is available to the public. Supervision of citizens' associations and the legality of their work is the responsibility of the municipal police.

Funds must register with the Serbian Ministry of Culture, which is responsible for granting the permit upon registration. The Serbian Ministry of Culture is also responsible for supervising funds. In addition, the work of funds and their data shall be available for inspection by the public.

6. Tax Treatment

Citizens' associations and funds are subject to sales tax, the enterprise profits tax and property taxes.³⁹ As noted above, the Sales Tax Law includes a service sales tax (the taxpayer is the provider of the services), which is assessed on fee income. Services include "banking and other services." (Sales Tax Law, Art. 12) (Presumably, if an NGO were permitted to lend without a license from the NBY, it would be assessed a service sales tax on the services it provided.) There is a service sales tax exemption for services relating to "social welfare" (although it is not at all clear whether this would apply to

³⁹ The authors were told, during their meetings with UNHCR implementing partners IRC and DRC, that the United Nations Development Program is planning to organize a team to work on favorable tax treatment of associations.

microfinance activities for the poor, if such activities were permitted by an institution not licensed by the NBY).

A nonprofit is subject to the enterprise profits tax if the nonprofit "earns income by selling products on the market or providing services for a fee." (Enterprise Profit Tax Law, Art. 1, para. 3.) However, a tax exemption applies to any nonprofit which declares net income of YUM 300,000 (less than \$4,500 at current exchange rates) or less if (i) the organization does not distribute the surplus to its founders, members, executives, employees or persons "associated" with them, (ii) the salaries paid by the organization to its employees, executives and persons "associated" with them are not greater than twice the average salary paid by similar organizations and (iii) the organization does not distribute assets in favor of its founders, members, executives, employees or persons "associated" with them.⁴⁰ However, no such exemption applies if the nonprofit has net income in excess of YUM 300,000 or if it enjoys a "monopolistic or dominating position" according to the anti-monopoly law. (Enterprise Profit Tax Law, Art. 44) Other aspects of the enterprise profits tax discussed in section III.B.7. above with respect to JSCs and LLCs apply equally to nonprofit legal forms that are subject to the tax.

As noted above with respect to enterprises, any taxpayer that, through a newly established operating unit, generated profit in an underdeveloped region is entitled to an enterprise tax reduction for two years (in proportion to the share of such profit in the total profit of the enterprise).

Citizens' associations and funds also pay property taxes to the extent that they own or have other specified rights (including, among other things, the right of use and occupancy and the right of time-sharing) with respect to real estate. However, property tax is not payable with respect to real estate that is used for humanitarian purposes. (It is not clear whether microlending to the poor would constitute humanitarian purposes under Serbian law.) There are additional exemptions applicable to certain real estate, including urban building land of a specified maximum size. Property tax is also paid (by residents only⁴¹) on property rights related to registered shares and interests in LLCs.

Donations to associations and funds are exempt from taxation. Membership fees (for associations) are deductible expenses for the purpose of calculating profits tax.

7. Legal Feasibility of Transformation

No provisions allow for nonprofit legal forms to transform into enterprises. Since nonprofit legal forms are not presently permitted to lend (except under the protection of a bilateral agreement), there is no precedent for a nonprofit organization to form a JSC or LLC and contribute loan assets (or an entire loan portfolio) in exchange for shares (as has been done in other countries).

⁴⁰ "Associated persons" are understood to involve a control relationship, which may be established by having 50% or more of the shares or voting power.

⁴¹ An enterprise is deemed to be a resident if it was formed or has its head office in Serbia; conversely, an enterprise is non-resident if it was formed or has its head office outside of the territory of Serbia.

IV. Lending Activities and Collateral

A. Lending Activities

As previously noted, only banks and other NBY-licensed financial organizations are permitted to issue "credits" under the LoB. While the Law of Contracts and Torts has no restrictions on who may extend "loans," the uniform interpretation is that there is no restriction on "loans" of non-monetary objects but that no legal entity other than banks and other NBY-licensed financial institutions may make monetary loans.⁴² There are no legal provisions (in the Law of Contract and Torts or elsewhere) dictating the form of a loan contract or any specific requirements with respect thereto.

B. Interest Rates

There is no restriction on interest rate levels (except in the event of a state of emergency, when the NYB is authorized to cap interest rates). However, the Code of Conduct of Yugoslav commercial banks (adopted by the Association of the Yugoslav commercial banks and other financial organizations) defines the basic criteria pursuant to which banks determine the interest rates.

C. Collateral

The Law on the Elements of Property Law provides that one may pledge movable property, immovable property and property rights. Some practitioners take the view that, in Serbia, a non-possessory pledge is possible under the Enforcement Law. However, while it is possible to register a "non-possessory pledge" at the commercial court, which serves to simplify the enforcement procedure,⁴³ this does not create a proprietary right for the pledgee. Although the pledgor is prohibited from selling or otherwise transferring pledged property to a third party (and violation of the law carries civil and criminal penalties), if it does do so, the pledgee has no right with respect to the assets.

It is possible to have a guarantee of payment or performance of other obligation. There is no limit on the number of guarantors with respect to any obligation.

⁴² This interpretation is different from many other countries in Eastern Europe, where lending provisions under the civil code are interpreted to permit lending by any natural or legal person; what is typically not permitted under the civil codes of other countries in the region is financial intermediation of any sort.

⁴³ The signed minutes from the appearance of the parties in court have the legal power of a court decision. (The minutes record the existence of a debt and the due date and affirm that the registration of the agreement constitutes security for the creditor's claim.)

Appendix A

Assessment and Recommendations

I. Introduction

The current legal and regulatory environment for microfinance institutions in Serbia is extremely challenging. However, the challenges are perhaps no more significant than in other countries in the region where legal and regulatory strategies have been devised to get the sector off to a promising start.

It may appear, given the current situation – specifically, the stance of leading policy makers at the NBY – that this is not the most auspicious moment to undertake liberalizing reforms. However, this may in fact be a uniquely promising time to plan and undertake targeted actions to improve the legal and regulatory operating environment and foster the development of the sector generally for the following reasons:

- Virtually all commercially related legislation is already slated for (or even already in the process of) reform. This provides an opportunity to ensure that microfinance legal and regulatory concerns are considered as part of the broader commercial law reform effort, rather than as a separate agenda. Serbia is expected to receive two financial sector structural adjustment credits from the World Bank in the next eighteen months. The conditionality associated with these credits can be used to assure that microfinance legal and regulatory concerns receive this consideration.
- If the March 14 pact on confederation with Montenegro (or a similar confederation agreement) advances,⁴⁴ an opportunity will open for a broad debate on the appropriate configuration of the Serbian government, once the current federal level institutions such as the NBY are integrated into it. At the very least, this should include a chance to push for separate regulatory treatment for non-depository financial institutions such as NGO-based microlenders.
- Technical assistance is presently available to the Bank Supervision Department of the NBY through the USAID-funded advisors, whose mandate is to promote risk-based prudential regulation and supervision of *depository* institutions. These advisors are already encouraging the NBY to restrict its supervisory focus to depository institutions rather than squander its limited resources on non-depository institutions.
- Senior officials in various public sector institutions do understand the potential for microfinance. These people can be mobilized to support liberalizing reform if they themselves are supported (i.e., given the necessary tools and information to publicize and promote a pro-microfinance viewpoint).

⁴⁴ See Appendix B. "Legal and Political Context."

- MFB (with support from EBRD) has already engaged the NBY in policy discussions on the practical operational difficulties that the current prudential regime presents for depository financial institutions. MFB can be expected to continue to press on these themes. This provides an opportunity for other donor-funded reform initiatives to put more focus on the issues of non-depository institutions.
- Donor resources for microfinance are currently available and will likely move elsewhere if a safe legal space is not found to permit development of the microfinance sector in Serbia. Moreover, these donors are unlikely to look favorably on the idea of handing their capital over to the state-owned National Savings Bank, as suggested by the NBY, at precisely the same time they are providing substantial assistance for privatization and the general development of the private economy.
- The growth and increasing strength of the programs being carried out by UNHCR's implementing partners mean that growing numbers of persons will be returned to the ranks of "social cases" if a legal way cannot be found instead to allow these programs to continue their development towards free-standing, sustainable NGO MFIs.

It should also be noted that the NBY's current stance frames a false dichotomy between the safety and soundness of the financial system and the broadening and deepening of the financial sector. This is not to say that the NBY's concern to prevent a repeat of the pyramid schemes and other sorts of abuses that helped to precipitate the collapse of the financial sector and monetary system in the early 1990s are not well-founded. It is merely to suggest that prudential regulation and supervision by the NBY (or its successor) may not be the best means to these ends.

The recommendations made below are grouped very roughly according to proposed timetable and relative urgency of the reforms and other activities recommended. This ordering is based upon the situation existing in March 2002, including pending or planned legislative and regulatory changes. The prioritization suggested is likely to require adjustment as the situation changes.

II. Necessary Short-Term (1 - 6 months) Actions

Education and policy awareness-building

The most significant obstacles to the development of an enabling legal and regulatory environment for microfinance in Serbia at the present moment appear to be the combination of (i) overly conservative thinking within the NBY and (ii) the absence of a well-mobilized and well-informed lobby within the public bodies that have most to gain from the development of a strong microfinance sector in Serbia. Both can be worked on through education and policy awareness-building.

With the NBY and its supporters elsewhere in government, policy awareness activities in the short term should include attention to, and should build upon, the following themes:

- Start-up, non-depository MFIs (where they have been permitted the legal space to develop, in the region and internationally) have *not* led to pyramid schemes or similar abuses, even in the countries where these problems have been most severe.
- The best tools for preventing pyramid schemes and similar abuses outside the realm of depository financial institutions involve *non-prudential* regulation, and non-depository MFIs *should* be subject to these kinds of controls, just like other actors in the economy. To the extent that ostensibly non-depository institutions of any sort (including MFIs) cross over to illegal unlicensed deposit-taking, they should be subject to the same regulatory treatment as other depository institutions (including sanctions for operating without a valid license).
- Cleaning up the banking sector doesn't have to come at the expense of economic growth and the broadening and deepening of the financial sector to reach lower income citizens and their business. Statistics regarding both the success of existing programs (particularly factors such as high repayment rates) and the strong demand for microfinance are useful to demonstrate the potential of the concept, and should be developed. Projections of the economic growth potential lost to Serbia through the loss of donor capital for microfinance would also be useful.

The thrust of policy awareness-building among public officials who are already positively predisposed to the concept of microfinance should be aimed toward mobilizing and informing them to serve as a more effective lobby for regulatory liberalization. This should begin with the same themes used in policy awareness-building with the NBY and its supporters. In particular, it will be necessary for supportive officials to understand how the NBY's legitimate concern to prevent a repeat of the abusive financial schemes of the early 1990s can be achieved through non-prudential regulation.

In addition to the content of microfinance-related education and policy awareness-building for public officials, it is important to focus attention on the incentives that will convince officials to participate in policy awareness activities. Incentives include projections of the economic growth and reduction in poverty and social welfare costs that are possible if low-income entrepreneurs have access to donor funding for microfinance. The possible political costs of being blamed for *losing* these donor resources through unwarranted regulatory conservatism may also constitute a useful incentive. Perhaps the most potent incentive, however, may be the use of conditionality associated with the World Bank financial sector structural adjustment credits. The first such credit is due to be negotiated imminently. It is therefore unrealistic to contemplate stringent microfinance-related conditionality (such as legislative reform) that would require significant advance preparation. However, it is both realistic and advisable in the context of the negotiations to call for further study of the potential of microfinance in Serbia and

appropriate legal and regulatory strategies to permit its development while safeguarding the financial system (as has been suggested by members of the team working on the credit). This could set the stage for consideration of more meaningful conditionality for the second structural adjustment credit, as discussed below.

Monitoring and supporting relevant reform initiatives

While education and policy awareness activities are being developed and implemented, work will be progressing on a variety of reform initiatives that will have a bearing on microfinance. The following steps are recommended⁴⁵ in connection with monitoring and supporting such reform initiatives:

Working Group. At the moment, there is no organizational point of coordination to: (1) monitor economic and commercial reform initiatives; (2) assess their probable impact on microfinance; and (3) look for opportunities to ensure the initiatives are microfinance-friendly. An on-the-ground working group to provide this type of coordination (even if convened an ad hoc basis) would be advisable.

Law Reform Projects. Among law reform projects already in process, particular attention should be paid to those initiatives addressing NGO legal forms and commercial enterprise legal forms. These laws are likely to define the basic operating rules for non-depository MFIs once the regulatory constraints against these types of institutions are lifted. The new draft law on associations (promoted by the Serbian Ministry of Justice) that would enable legal entities and foreigners to form and be members of associations is to be considered by Parliament in late March or early April and is of direct importance. As the drafts of this law progress, attention should be focused on the extent to which the new law allows: (1) both foreign and domestic legal entities and individuals to found and be members of associations (as does the draft shared with the authors); (2) flexibility in designing the governance structure of associations; and (3) associations to engage economic activities directly related to their charter purposes as their primary activity and without the need to form a separate legal entity for such purposes. Frequent communication with ICNL regarding the progress of this legislation will be helpful, especially because NGO legal reform does not appear to have the attention of commercially and economically focused legal reform initiatives.⁴⁶

World Bank Conditionality. As mentioned above, negotiation of the first World Bank financial sector structural adjustment credit (scheduled to take place in early April) can be used to call for further study of the potential of microfinance in Serbia and

⁴⁵ We have not recommended at present pursuing the "decree" route with respect to NGO-based credit-only microfinance (i.e., along the lines of the Montenegrin decree). Without the support of the NBY, this solution is almost certainly a political impossibility. Even if politically feasible, such a governmental decree provides (at best) a weak legal footing for establishing microfinance institutions, especially in the face of arguably inconsistent laws and regulations.

⁴⁶ The UNHCR implementing partners have monitored the progress of, and commented on, federal level proposals to adopt a law on foreign NGOs. This subject is, of course, of direct operational relevance to the UNHCR implementing partners as long as they operate as foreign NGOs rather than through locally formed legal entities.

possible legal and regulatory strategies to permit its development while safeguarding the financial system. More importantly, the second credit is due to begin planning already in May. With the second credit there will be time to work on the concept for more meaningful and forceful conditionality aimed at liberalizing the legal and regulatory operating environment for microfinance.

Interim operating strategies

As it is possible that the UNHCR might discontinue support for its microlending program sometime in the next twelve months, it is important to develop strategies that would ensure that the UNHCR implementing partners could continue to operate without the protection of the UNHCR bilateral agreement. Regardless of UNHCR's actions, such strategies are needed in order to permit new microlending organizations and programs to enter the market.

Bilateral Agreements. There should be an investigation of the bilateral agreements between Yugoslavia and other "microfinance-friendly" governmental and multilateral donors, including the United States, the United Kingdom, Canada and the Scandinavian countries to determine whether they can be used to shelter new microfinance programs (as well as the current UNHCR implementing partners, in the event that the UNHCR discontinues support for its microlending program).

Partnering Arrangements with Commercial Banks. It is possible that partnering arrangements could be established with commercial banks, with the bank either acting as agent for existing and new microfinance programs or on-lending funds provided by donors or international financial institutions, as has been done in the other countries in the region.⁴⁷ To the extent that commercial banks are resistant to entering the microlending business (at least one bank that is heavily involved in SME lending told the authors that its minimum loan amount is 5,000 Euro), they may be persuaded to enter the market if they have access to donor-funded technical assistance.

National Savings Bank. It may be advisable to commence a dialogue with the persons at the state-owned National Savings Bank regarding possible partnering arrangements with would-be NGO MFIs. Any such discussions merit a cautious approach by supporters of microfinance (whether public officials, donor representatives or practitioner groups) in order not to support inadvertently the idea of the National Savings Bank having a state-controlled monopoly on financial service delivery to low-income persons and entrepreneurs.

III. Necessary Medium-Term (6 months - 12 months) Actions

Education and policy awareness-building

⁴⁷ A logical candidate might be Komercijalna Banka, as the UNHCR implementing partners have already established loan serving arrangements with that bank.

The education and policy awareness-building recommended above for the short term will certainly not be "completed" in a six-month time frame. It is likely, in fact, that the implementation activities will only be getting properly organized toward the latter part of this time period, even if resources to cover the costs of organizing these activities and appropriate personnel to carry them out can both be identified quickly. This means much of the work on this front will take place in the medium term rather than in the short term.

Consideration is being given by the organizers of last year's NIS Policy Forum on Microfinance Law and Regulation to broadening the event this year to include several delegations from Central and Southeastern Europe. The Forum, to be held in late October or early November, will bring together small national delegations from participating countries composed of high-ranking officials from central banks, ministries of finance and other relevant bodies (selected by the organizers) with the goal of improving understanding and support for microfinance among policy makers who will be key to the development of a sound legal and regulatory environment. If delegations from Central and Southeastern European are to be included, it would make an ideal environment for Serbian policy makers to share concerns with and learn from their peers. If the event is not expanded to include Central and Southeastern European delegations, it will make sense to consider organizing a separate event for this purpose.

Monitoring and supporting relevant reform initiatives

Predicting the specific relevant reform initiatives that will be active and reaching a critical phase six to twelve months out is difficult at the present time.⁴⁸ Even from the current vantage point, however, it can probably be safely assumed that opportunities will arise in the final quarter of 2002 and first quarter of 2003 to make progress in the following general areas:

Banking law changes. The NBY-supported changes to the banking law that are expected to receive imminent parliamentary consideration are, according to NBY staff, amendments necessary to adopt prudential regulations that are more in keeping with Basel standards. The amendments do not, in any sense, constitute a significant structural reform of the Law on Banks. However, such far-reaching reform has been proposed by the USAID-funded advisors to the NBY Bank Supervision Department. If a new law along the lines proposed by the advisors is developed, it will (among other things) exclude non-depository institutions from licensing and prudential regulation and supervision by the NBY. This change will offer an opening to work for a sensible and enabling approach to non-prudential regulation of credit-only MFIs.

NGO law changes. It is possible that no new law on associations will be adopted during the next six months, leaving this front still active during the next six-month period. Particularly if an opportunity arises in the context of banking law reform to

⁴⁸ This problem highlights the need for a task force or working group focused on microfinance-related legal and regulatory reform in the short-term, to "keep on top of" the fast-changing commercial and economic reform agenda.

develop a scheme for non-prudential regulation of credit-only MFIs, it will be important for there also to exist a workable NGO legal vehicle for these purposes.

Tax law changes. Even if no top-to-bottom overhaul of the Serbian tax system takes place in the final quarter of 2002 or first quarter of 2003, there may be amendments proposed to existing tax laws that could offer an opportunity for changes beneficial to the microfinance sector. These should include a clarification that the service sales tax exemption for services relating to "social welfare" should apply to microfinance activities for the poor. If banking law reform during this time period permits the development of a scheme for the non-prudential regulation of credit-only MFIs, this would also be a logical time to work for the definition of NGO-based microfinance activities that will not be subject to profits tax (although the enterprise profit tax law would also require a parallel amendment to avoid unequal treatment of other nonprofit organizations).

Changes to laws related to foreign currency borrowings. MFIs commonly fund their activities through borrowings from international sponsors. The Foreign Credit Transactions Law would require NBY approval for such loans. The law should be liberalized to permit categories of international microfinance sponsors to lend to MFIs without NBY approval. In addition, support should be given to MFB's efforts to liberalize foreign currency lending by MFIs.

Interim operating strategies

If research into the provisions of bilateral agreements over the next six months yields promising results, efforts in the period thereafter could be focused on developing implementing strategies to make use of the agreements in question. This will present potential legal and diplomatic challenges, given the wide variability common in the provisions of such agreements and given that they are not generally negotiated with the idea in mind of working in close harmony with other similar agreements negotiated by other donors.

It is possible that the identification of bilateral agreements that could provide protection to microfinance programs or institutions may require more than six months. In addition, it is possible that appropriate arrangements might not be made to work for some of the UNHCR implementing partners and potential new entrants into the microfinance market. (This will, of course, depend upon the provisions of the agreements in question as well as the sources of funding.) It will therefore be advisable to continue work investigating the feasibility of partnering arrangements with licensed financial institutions.

IV. Necessary Long-Term (more than one year) Actions

In the long term, it can be predicted that follow-up actions will be needed on all the fronts discussed above. The experience of microfinance-related legal and regulatory reform in other countries in the region suggests that a year is too short a period to accomplish a significant amount of reform, even when there is a greater political

consensus on the nature of needed changes than is likely to emerge in Serbia in the coming months. In fact, it will be a significant accomplishment if real progress can be made in this time frame just on the issue of creating a safe legal space for NGO-based microlending.

Assuming, however, that real progress can be made over the next twelve months on liberalizing the regulatory picture to permit the formation and operation of credit-only NGO MFIs, the focus during the following year should turn to the issues of (1) long-term access to capital by NGO MFIs after donor resources become scarce, and (2) the rest of the spectrum of financial institutions that might be developed to target low-income clients. These issues are related, in that one means of accessing new sources of capital may be for NGO MFIs to transform into a commercial finance company or even a licensed depository institution. Under current rules, no such transformation options exist.

The elaboration of the legal and regulatory framework to include additional forms of financial institutions is also critically important for reasons unrelated to the transformation options for NGO MFIs. Credit is only one of a number of financial services to which low-income persons and entrepreneurs typically lack convenient access. Safe and trusted savings opportunities, in particular, can be equally important. It is increasingly widely accepted that a diverse array of types of microfinance institutions helps to lead to an increase in access to a broader array of financial services for the poor.

"Filling in the gaps" in the Serbian financial sector so that there will ultimately be a continuum of different legal forms available -- from simple credit-only NGO MFI on up through full scale commercial bank -- can obviously only be a realistic objective over the long term. However, it is a useful objective to have in mind from the start.

Appendix B

Legal and Political Context

The Republics of Montenegro and Serbia are the last remaining members of the Federal Republic of Yugoslavia. Montenegro has ceased recognizing the authority of federal law for most purposes other than national defense. In Serbia,⁴⁹ two sets of laws and regulations and two sets of governmental institutions remain, one at the federal level and one at the republican level.⁵⁰

For some time, proposals have been advanced for the redefinition of the relationship between Montenegro and Serbia into a loose confederation. On March 14, 2002, leaders in both republics announced a pact (supported by the federal President) that will, if approved by both republics' parliaments, result in the abolition of most federal institutions and legal authority. The pact leaves open some key questions about the degree of economic integration of the proposed confederation. For example, such important issues such as the choice of currency (Euros or Dinars), separate or unified customs and the drafting of a joint constitution have all been left to be "harmonized" in the future.

If this proposal (or any similar confederation proposal) advances, it is assumed in Serbia that most existing federal institutions would dissolve or be transformed into Serbian institutions and the existing federal laws and regulations would be made applicable to Serbia, while being harmonized with the existing Serbian laws and regulations. In the meantime, legal and regulatory authority in Serbia remains divided between federal and republican institutions and reforms must be undertaken through the proper channels at both levels of government.

The situation is further complicated by the current division of political power, which will affect, among other things, the prospects for approval of the proposed confederation pact and resulting reforms. The federal government is under the control of President Kostunica and his party and its political allies. The National Assembly (federal) includes representatives from Montenegro who are in a position to block legislation that they oppose and who favor continuation of the Yugoslav Federation (rather than the confederated or independent status favored by those in power at the republican level in Montenegro).

In Serbia, Prime Minister Djindjic and his DOS coalition (which includes Mr. Kostunica's party, despite critical policy disagreements between Mr. Kostunica and Mr. Djindjic) control the republican level government and parliament. This permits Mr. Djindjic and DOS to pass republican legislation without needing the cooperation of representatives from Mr. Kostunica's party.

⁴⁹ Kosovo remains part of the territory of Serbia, but is governed under separate rules established pursuant the United Nations protectorate. References to the legal and regulatory environment for microfinance in Serbia in this Survey are not intended to include Kosovo.

⁵⁰ The authors were advised by local counsel that only Serbia funds the federal state and its operations.

As most of the laws and regulations relevant to microfinance fall within federal jurisdiction, most reform measures would require cooperation between potentially opposing political forces, and the potential for stalemate is significant. Notwithstanding this, there are currently a large number of market-oriented legal reform efforts -- at both the federal and the republican level -- that enjoy support from both Mr. Kostunica and Mr. Djindjic and aggressive timetables have been set for drafting and parliamentary adoption (at whichever level government is relevant) of much commercially related legislation.⁵¹ In fact, in many cases, draft legislation is in preparation by or under the auspices of republican level institutions even though it will require adoption at the federal level.

⁵¹ A list of these projects is set forth in Appendix F.

Appendix C Sources Consulted

Federal Legislation:

- Law on Audits of Financial Statements
- Law on Banks and Other Financial Organizations
- Law on Bankruptcy and Liquidation of Enterprises
- Law on Contract and Torts (dated 1997)
- Law on the Elements of Property Law Relations
- Law on Foreign Exchange Transactions
- Law on Foreign Credit Transactions
- Law on the National Bank of Yugoslavia
- Excerpts of the 2000 Law on Executing Proceedings

Serbian Legislation:

- Act on Social Organizations and Associations of Citizens
- Law on Legacies, Foundations and Funds
- Tax Legislation:
 - Sales Tax Law
 - Financial Transaction Tax Law
 - Salary and Wage Fund Tax Law

Treaty:

- Agreement between the UNHCR and the Federal Government of the FRY

Draft Legislation:

- Federal Ministry of Justice's Proposal of the Law on the Activity of Foreign Non-Government Organizations on the Territory of the Federal Republic of Yugoslavia
- Serbian Ministry of Justice's Nacrt zakona o udruženjima (Draft Law on Associations)

Other

- World Bank Project Concept Document for Local Initiatives Project in FRY
- Table of current legal reform projects ongoing in Serbia
- Various internal EBRD documents relating to the application of current law and regulations to commercial banks
- KPMG Consulting, Inc./Barents Group Preliminary Diagnostic Report on the Legal Structure for Banking Supervision in Yugoslavia (prepared for the NYB and USAID by Gary A. Gegenheimer), March 30, 2001⁵²

⁵²This document was consulted but not reviewed extensively by the authors of the Survey.

Appendix D Persons Consulted

Roberto Albisetti, Chief of Mission of Belgrade Office, International Finance Corporation

Jela Baćović, Director, Federal Ministry for Foreign Economic Relations

Nina Bulatović, Managing Partner, KPMG d.o.o. Beograd

Daniel Callis, Senior Consultant, Barents Group, KPMG Consulting, USAID Advisers to NBY on Bank Supervision Project

Frederique Dahan, Counsel, Legal Transition Team, Office of the General Counsel, European Bank for Reconstruction and Development

Francis Delaey, Counsel, Office of the General Counsel, European Bank for Reconstruction and Development

Braco Saša Dimitrovski, CEO, MicroFinS

Željko Gajić, Legal Adviser, National Bank of Yugoslavia, Department for Banking Supervision, Legal Affairs Department

Milena Gojković, Program Manager, Danish Refugee Council

Dragan Golubović, Senior Legal Adviser, International Center for Not-for-Profit Law

Charlotte Gray, Banker, Group for Small Business, European Bank for Reconstruction and Development

Peter Krcmar, Legal Officer, International Rescue Committee

Gordana Lazarević, Assistant Minister, Serbian Ministry of International Economic Relations

Maniza Naqvi, Operations Officer, Team Leader for Local Initiatives Project in Serbia and Montenegro, World Bank

Gordana Matković, Minister, Ministry of Social Affairs

John Mayshak, International Rescue Committee

Rory C. O'Sullivan, Country Manager, The World Bank, Country Office for FRY

Dr. Blagoje Paunović, Head of Department of SMEs, Serbian Ministry for Economy and Privatisation

Henry Russell, Director, FRY Office, European Bank for Reconstruction and Development

Hans Schrader, Senior Advisor, Private Sector Development Team, Southeast Europe Enterprise Development

John Schubert, Opportunity International

Mileca Stranjaković, Adviser, Serbian Ministry for Social Affairs

Milos Terzan, Program Assistant, United Nations High Commissioner For Refugees

Goran Tinjić, Operations Officer, Sarajevo Office, World Bank

Bojana Vukašinović, Senior Banking Advisor, Economic Policy and Finance, USAID

Kathryn Woolford, Chief of Party, Barents Group, KPMB Consulting, USAID Adviser to NBY on Bank Supervision Project

Appendix E
Translation of October 2001 Letter from
The Yugoslav National Bank to the
Serbian Ministry of Economy and Privatization

NATIONAL BANK OF YUGOSLAVIA
Vice-Governor

Number: IV/143-2455

Belgrade, 15 October 2001

MINISTRY OF INDUSTRY AND PRIVATIZATION
OF THE REPUBLIC OF SERBIA
- **Assistant to the Minister, Dr Pavle Popovic**

BELGRADE

Nemanjina 22-26

Dear Mr. Popovic,

The National Bank of Yugoslavia has been informed that Your Ministry is currently working on a by-law that would define the issues of micro credits, in line with the "Draft Decision on Methods of Approving Micro Loans to Natural Persons and Legal Entities". In the version currently available to us, it is formulated in the following way:

- in the spirit of this decision, micro credit organizations would be understood as associations of citizens, foundations and other nonprofit organizations designated as non-banking organizations, although this decision invests them with the right to give credits, which is a banking business, by definition;
- issuing of operating licenses, regulation of the methods of bookkeeping and supervision over the operations of micro credit organizations would be under the jurisdiction of the National Bank of Yugoslavia, although it is simultaneously defined that business operations pursued under the conditions set by this Decision are subject to review in accordance with the legislation of Serbia.

On the other hand, Draft Decision does not define conditions under which the National Bank of Yugoslavia would be issuing licenses to the micro credit organizations, that is whether they would be required to have founding capital since they multiply money. Would these organizations be bound to comply with the Basel standards that are incorporated into our banking legislation, which would then be the conditions for revoking licenses from these organizations. The Draft Decision also does not set maximum allowed credit amount that these organizations would be authorized to approve, i.e. what would be considered a micro credit and in which currency would those credits be approved. Most importantly, it is not clear from the above mentioned Draft Decision why it is necessary to make donor assets available through the micro credit organizations and not through the existing banks or through the savings bank that the Republic of Serbia could establish for that purpose from the donor funds. The founding documents and

business policy papers of the savings bank would define approvals of microcredits as its topmost priority activity.

Leaving aside the issue that the rights and obligations of the National Bank of Yugoslavia can not be instituted by the regulations of Serbia, we wish to remind you of the fact that the destruction of the monetary system of FRY during 1992 and 1993 was to a significant extent conditioned by other financial organizations which, like the microcredit organizations in the Draft Decision, had only been loosely regulated and which reached the figure of 1800 in mid 1993. Having in mind that experience, we are extremely skeptical towards any attempt to enable institutions, which are not founded and do not operate in accordance with the Law on Banks and Other Financial Organizations ("Official Gazette of FRY", No. 32/93, 61/95 and 44/99), to enter banking business, even if it is just to a small extent.

Sincerely.

VICE-GOVERNOR

Radovan Jelasic

Appendix F
Legislative Reform Projects⁵³

Ministry In Charge/Cooperating	Project
Federal Ministry of Finance	Law on International Trade Arbitration Law on Capital Markets Law on Investment Funds
Federal Ministry of Foreign Economic Relations	Law on International Trade Law on Free Zones Law on Foreign Investments Law on Concessions
Federal Ministry of Economy and Internal Trade	Company Law (Enterprise Law) Competition Law
Federal Ministry of Justice	Law on Secured Transactions/Registry Law Law on Compulsory Composition, Bankruptcy and Liquidation Property Law Leasing Regulation
Serbian Ministry of International Economic Relations	Law on Concessions Law on Secured Transactions/Registry Law Law on Free Zones Law on Capital Markets Law on Investment Funds Law on Foreign Investments
Serbian Ministry of Economy and Privatization	Company Law (Enterprise Law)

⁵³ This list is based on a table supplied to the authors in February 2002 by Frederique Dahan, a lawyer on the Legal Transition Team at EBRD. The Belgrade Resident Office of EBRD hosts a monthly coordination meeting on commercially related legal reform initiatives in Serbia. The coordinating meetings have been convened and chaired by personnel from Booz Allen – a USAID implementing partner, who gathered in the information contained in this list. This list has not been updated recently and does not contain some relevant reform initiatives, such as the Serbian Ministry of Justice's work on a new law on associations.