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**The Legal and Regulatory Obstacles to
be removed in order to Scale-Up
Microfinance in Serbia**

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- **There is a number of legal and regulatory obstacles to be removed in order to scale-up the microfinance industry**
- **The topics should be addressed predominantly to the NBS and the Ministry of Finance, but other actors should be involved as well**
- **The recommendations for the legal and regulatory changes should be applied cumulatively in order to have the desired impact.**

I. Link microfinance scaling-up to bank restructuring and commercial bank downscaling

Involve the same actors in the process, i.e., the National Bank of Serbia, Ministry of Finance, Bank Restructuring Agency, etc.

II. Continue with commercial law reform

Addressed: To all competent state authorities which are in charge of the commercial law reform

Facilitate collateral registration: Due to the regional division of tasks, some courts are competent. As a result, debtors are required to travel from one city to another just to register collateral, which is consuming time-wise and also decreases the motivation. Ideally, the court system should be adapted. As this is not so likely in the near future, in order to solve this problem, the NBS establish a Central Register of pledges which would have branches in all of the major cities.

Decrease the court taxes for registering collateral: The costs of collateral registering are too high. Having in mind the small amount of the micro loan, the costs of collateral pledging can constitute a significant part of the loan. The court taxes could be easily lowered as they are unfairly high for the microcredit clients, i.e. the registration of collateral takes approximately 10 to 15 minutes of work for the court.

Introduce the Central register of pledges: There is no central register of collateral yet, although it is foreseen in the law. This creates adverse incentives with the debtors, as they can pledge the same collateral for more than one loan. The Central register of pledges should be operated and monitored by the NBS

III. Lobby with NBS to facilitate microfinance

Addressed: To the National Bank of Serbia

Decrease the compulsory reserves with the NBS: The banks as well as other financial organizations, as defined in the Serbian Law on Banks, are obliged to keep a compulsory reserve with the National Bank of Serbia. Banks find this requirement especially burdensome since the compulsory reserve can otherwise be used for the on-lending portfolio. This makes the loans more expensive and the cost is born by the clients. There are five types of the compulsory reserve.

Alleviate foreign exchange positions: The foreign exchange position imposes a restriction of the open currency position and borrowing on a preferential rate from IFIs. In this case, consequently, the dinar lending is fixed to the exchange rate and the risk is borne by the borrowers. The fact the banks generally only engage in Dinar lending indexed to foreign currency shifts the exchange risk to customers and this means, that if borrowers are able to repay, a bank will have funds on hand to repay its foreign currency borrowing.

Introduce Credit Dossiers for all debtors: companies, entrepreneurs, physical persons. There is no central register of loans, so individuals may take several loans in different banks, which creates problems in repayment. Also, the Credit Dossiers would provide information about the credit history of the debtors. The situation is slightly better regarding when dealing with registered companies, since the bank has insight into the balance sheet and income statement. The Credit Dossiers should be operated and monitored by the NBS

IV. Adopt the new banking law

Addressed: To the NBS and the Ministry of Finance

Include provisions that would facilitate microfinance development in Serbia: Besides the above mentioned points addressed to the NBS, the new banking law should facilitate the reform of the banking sector, allow new foreign banks to enter the market with new investments and facilitate the restructuring / privatization of the existing state owned banks.

List the Serbian banks on the Stock Exchange market: In this way new investments could enter the banks. According to the existing practice, banks are sold to one or two investors and thus closed companies are created. This is a proposal for the new banking law, but at the same time, it is also conditioned by the readiness of the Serbian capital market to list the banks.

V. Adapt internal regulations in Downscaled Banks

Addressed: To commercial banks in the process of downscaling

Create a scoring system for clients' loan applications: The scoring system would facilitate the work of loan officers and provide less arbitrary decision making on loan applications. It should be created through the banks' internal regulations, using the banks' policy as a guideline.

Establish and review periodically internal procedures for granting credits and making investments: In order to establish an appropriate and properly controlled credit risk environment the following components should be included: A) Sound and well-documented credit granting and investment; B) Maintenance of an appropriate credit administration, measurement and ongoing monitoring/reporting process (including asset grading/classification); C) Ensure adequate controls over credit risk. This should be done through the banks' internal by-laws.